United States Court of Appeals

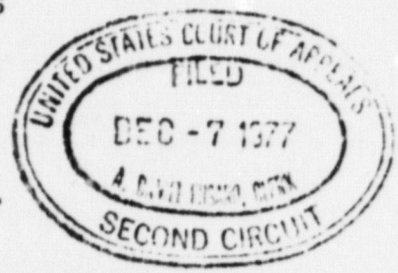
for the Second Circuit

APPELLEE'S BRIEF

75-6080

[PRINTED VERSION]

IN THE UNITED STATES COURT OF APPEALS
FOR THE SECOND CIRCUIT



SECURITIES AND EXCHANGE COMMISSION,

Plaintiff-Appellee,

v.

BERNARD J. COVEN,

Defendant-Appellant.

On Appeal from the United States District Court for the
Southern District of New York

BRIEF OF THE SECURITIES AND EXCHANGE COMMISSION, APPELLEE

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COUNTERSTATEMENT OF THE ISSUES PRESENTED

1. Whether an attorney, who was responsible for the preparation of a registered public offering of securities, and who purported to follow its course carefully and was otherwise intimately associated with the underwriters of that offering, may be held under the federal securities laws to have aided and abetted the fraud of one of the underwriters to the detriment of the issuer (his client), of persons purchasing in the public offering (his client's shareholders) and of the investing public generally, when

   (a) he authorized the disbursement of escrowed funds in violation of the terms of the escrow agreement, which he had drawn;

   (b) he subsequently ignored his responsibility, in view of the circumstances of his relationship to the underwriters,

to assure that the second portion of the underwriting was going forward; and

(c) he obtained, but ignored, information which indicated that during the underwriting one of the underwriters had induced a marketmaker to take action that aided the underwriter's unlawful manipulation of the price of the stock.

2. Whether the district court's order enjoining an attorney from future violations of antifraud and anti-manipulation provisions of the federal securities laws was an abuse of the court's broad discretion where the Commission had shown

(a) that the attorney's reckless and negligent conduct aided and abetted an underwriter's scheme to defraud the public in a registered public offering of securities and then to manipulate the public trading market in that stock, in violation of the federal securities laws, and

(b) that the attorney subsequently displayed a complete lack of sensitivity to the gravity of these violations and the resulting injury to the public, which led the district court to conclude that there was a "reasonable expectation" of similar conduct in the future, warranting injunctive relief.

STATUTES AND RULES INVOLVED

The pertinent statutes and rules are set forth in the Statutory Appendix, infra.

COUNTERSTATEMENT OF THE CASE

This is an appeal by defendant Bernard Jay Coven from an order of permanent injunction, barring him from future violations of antifraud and anti-manipulation provisions of the federal securities laws, entered on August 19, 1975, by the United States District Court for the Southern District of New York (Judge Pierce) in an enforcement action brought by the Securities and Exchange Commission against him and others. Findings of fact and conclusions of law were signed on June 30, 1975. On Coven's motion for reconsideration,

the district court refused to vacate or modify these findings; indeed, it reaffirmed and expanded them with respect to Coven. Memorandum Opinion dated August 19, 1975 (100a-117a). 1/

The Commission's action for an injunction was filed on July 5, 1973. In its complaint the Commission charged 11 persons and entities with direct violations or with aiding and abetting violations of antifraud and anti-manipulation provisions of the federal securities laws 2/ in connection with the 1972 registered public offering of the common stock of Dennison Personnel, Inc. One of the defendants, Robert B. Levin, who was underwriters' counsel for the public offering which formed the basis for the lawsuit, consented to the entry of a permanent injunction before trial.

After trial the district court entered injunctions against nine of the ten remaining defendants, including Coven (Order dated August 19, 1975). 3/ Coven is the sole appellant from the decision below.

1/ The district court's first opinion is reported at [1973-74] CCH Fed. Sec. L. Rep. ¶95,222. Its second opinion is not reported.

References to the joint appendix will be to "____a". References to appellant's brief will be to "Br. __".

2/ Section 17(a) of the Securities Act of 1933, 15 U.S.C. 77q(a); Section 10(b) and Section 15(c)(2) of the Securities Exchange Act of 1934, 15 U.S.C. 78j(b), 15 U.S.C. 78o(c), and Rules 10b-5, 10b-6, 10b-9, and 15c2-4 promulgated thereunder, 17 CFR 240.10b-5, 240.10b-6, 240.10b-9 and 240.15c2-4.

3/ The district court denied relief against the defendant Republic National Bank, on the basis that no violation by it had been shown (93a).

1. Statement of the Facts

On April 26, 1972, pursuant to Section 8(a) of the Securities Act of 1933, 15 U.S.C. 77h(a), the Securities and Exchange Commission declared effective a registration statement for the public offering of the common stock of Dennison Personnel, Inc., a Delaware corporation, incorporated in late 1969, and doing business in New York City (Court Exhibit 1, ¶1). The registration statement provided for the offer of 6,000,000 shares of common stock at a price of ten cents per share. Co-underwriters of the issue, as set forth in the registration statement and the prospectus, were defendant Carlton-Cambridge & Co., Inc., and Stevens Jackson Seggos, Inc. ("Stevens Jackson") 713a, 724a).4/ The terms of the offering provided, among other things, that the underwriters would use their "best efforts" to sell the 6,000,000 shares and that the first 3,000,000 shares would be sold on an "all or none" basis (id.). 5/

Pervasive fraud in connection with the sale of this issue to the public and subsequent market manipulation formed the basis for the Commission's enforcement action. As we will show, Coven's reckless and negligent conduct facilitated this fraud and manipulation of the markets.

A. Background

Since the company's founding in 1969, Dennison's president, Gerald P. Bowes, had been seeking to make a public offering of the corporation's

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4/ Stevens Jackson was not named as a defendant in the Commission's complaint.

5/ If the "all or none" portion of the offering, the "minimum", was not completely sold within the time period set forth in the registration statement, all investor funds were to have been refunded (Pl. Ex. 1). See Commission Rules 10b-9 and 15c2-4, 17 CFR 240.10b-9 and 240.15c2-4. See also Weiss, Registration and Regulation of Brokers and Dealers, (1965) at 120. A "best efforts" underwriting, in contrast to a "firm commitment" underwriting, does not require the underwriter to commit any capital and thus permits him to avoid the danger of loss on the unsold portion of the distribution. Securities and Exchange Commission, Special Study of Securities Markets, House Doc. 95, 88th Cong., 1st Sess. (Apr. 3, 1963), at 494-495.

stock (Tr. 28-29). In April 1970, a registration statement for an offering of Dennison securities was filed with the Commission but never became effective. (678a). 6/ Subsequently, in June 1971, Bowes was introduced to the defendant Coven (122a-123a), an attorney licensed to practice law in the State of New York who specialized in corporate and securities law (Court Ex. 1, ¶4; 456a). Coven had over 20 years' experience in the field (id.), having been involved in some 30 or more public offerings of securities (456a). On June 30, 1971, Coven was retained by Dennison as special counsel and given, at Coven's insistence, complete charge over the proposed issue (559a; 750a, 821a; Court Ex. 1, ¶23). 7/

Coven first arranged for Lehman, Bartel & Co. 8/ to underwrite the Dennison stock offering (127a-128a; 752a), and, accordingly, an amendment

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6/ This offering was to have been underwritten by the firm of Robert Cea & Co., but that firm went bankrupt before the issue could be offered (121a-122a). The registration statement contemplated the offer of 120,000 shares of Dennison common stock at $7.50 per share (678a). Alfred Greco, see p. 11, infra, was counsel to the issuer on the proposed offering (id.).

7/ Coven apparently brooked no interference (see 659a-660a). He rejected Bowes' attempt to have him work with company counsel, Alfred Greco, on the project (559a). Indeed, Bowes testified (185a-186a) that he and Coven

> "had many discussions on his way of doing business, which was to throw agreements in front of me and say 'Sign it,' . . . He had other things to do. I said, 'I would like to take this agreement back with me and read it before I sign it,' and he thought that was highly unusual for somebody to question his integrity."

As noted infra, p. 11, eventually during the events involved in this case, Bowes retained Mr. Greco as personal counsel with respect to the offering.

8/ The principals of that firm were friends and business associates of Coven (561a). In fact, the "letter of intent" between it and Dennison regarding the proposed underwriting was signed "Bernard J. Coven authorized"--for Lehman, Bartel (755a). Subsequently, a second version was executed by one of the principals of Lehman, Bartel (829a).

to the original April 1970 registration statement was filed with the Commission on November 26, 1971 (682a). 9/ In early 1972, however, Coven told Bowes that Lehman, Bartel was dropping out, but that Coven would find another firm to do the underwriting (130a). Since Coven had been trying to put together underwritings for Stevens Jackson since October 1971, he then arranged for that firm to handle the Dennison issue (191a-192a; 196a-198a; 566a-569a). Apparently, Coven originally had intended to use only Stevens Jackson to underwrite the issue (213a), 10/ but he subsequently proposed and Bowes agreed to add, as a co-underwriter on the Dennison offering, Carlton-Cambridge (132a), a firm which recently had underwritten another offering in which Coven had served as counsel for the issuer. (593a). 11/

9/ The amended registration statement provided for the offer of 150,000 shares of Dennison stock at $5 per share (682a).

10/ The Commission had alleged that Coven had procured Stevens Jackson's appearance on the registration statement as an accomodation only, never expecting any effort by that firm to sell the issue (7a ¶21). The district court seems to have agreed in part with the allegation, stating (58a) that with respect to Stevens Jackson "the representation in the registration statement and prospectus that best efforts would be used to sell the entire issue was false." The district court declined to find a violation by Coven in this respect, however, because some of the new issue was, in fact, sold by that firm and the selling group formed under its aegis (92a).

The Commission's proof at trial tended to show that Coven and the principal of Stevens Jackson (E. P. Seggos) had an unwritten agreement for Coven to feed underwriting business to the firm (192a). Pursuant to this understanding the Stevens Jackson firm would not actually sell the issue but rather collect the money and execute the necessary papers. Actual selling would be done somehow through, or by, Coven's office (197a-220a). This was the initial arrangement for the Dennison offering (200a).

11/ About the time of that association, this Court handed down its opinion in Securities and Exchange Commission v. Manor Nursing Centers, 458 F. 2d 1082 (1972), a case also involving fraud relating, inter alia, to an escrow arrangement in an "all or none" offering of securities to the public in violation of Section 17(a) of the Securities Act, and Rules 10b-5 and 10b-9 promulgated under Section 10(b) of the

(continued)

Coven also arranged for the American Stock Transfer Company to serve as transfer agent (428a-429a). Coven failed to reveal to Bowes the fact that he had represented American Stock Transfer Company on other matters (433a, 435a) and failed to inform Bowes of any aspect of Coven's previous relationships with either Carlton-Cambridge or Stevens Jackson (592a-593a).

Coven persuaded the Republic National Bank to act as escrow agent (265a-267a, 270a). This was the bank's first--and its last--such engagement (264a, 296a-297a).

On March 30, 1972, a second amendment to the registration statement was filed (686a). This amendment introduced Carlton-Cambridge and Stevens Jackson as underwriters and provided for the sale of 6,000,000 shares at ten cents per share (id.)--a change in the number of shares to be sold and the per share price (see, supra, nn.6, 9) suggested to Dennison's president by Coven (133a-134a; 469a-470a). The registration statement as thus amended became effective on April 26, 1972 (supra, p. 4).

In April, prior to the effective date of the offering, a "due diligence" meeting was arranged by Coven at Fraunces Tavern (136a). The meeting was more in the nature of a cocktail party (132a, 136a). Bowes, representing Dennison, did not recall seeing or conversing with any representative of Carlton-Cambridge (137a). He met for the first time a representative from

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11/ (continued)
Securities Exchange Act. In that case Coven represented three of the appellants at trial and on appeal, id. at 1087-1088, 340 F. Supp. 913, 917, one of whom, Christos Netelkos, was a principal of Carlton-Cambridge, 358 F. 2d at 1089. Accordingly, Coven, in the Commission's view, may be charged with detailed knowledge of the requirements of the federal securities laws with respect to "all or none" offerings.

Stevens Jackson; and he exchange a few words with Coven (136a). 12/

As part of the arrangement for the offering, Carlton-Cambridge, the Republic National Bank, Stevens Jackson, and Dennison entered into an escrow agreement covering the disposition of funds received in the offering (708a-710a). It had been drafted by Coven (636a) and was filed as an exhibit to the registration statement, which he also prepared. (550a; 708a). As represented in the prospectus to be distributed to public investors (see 724a-746a), also prepared by Coven (see 550a), this escrow agreement provided: "All monies received will be deposited in escrow at the Republic National Bank of New York . . . and returned promptly to subscribers in full without interest or deduction unless at least 3,000,000 shares are sold within 60 business days of [the date of the prospectus or an additional thirty days]" (724a, emphasis supplied). Paragraph 2(d) of the escrow agreement stated:

> "In the event that there shall not be $300,000 in the Escrow Account on the Delivery Date, or if no Delivery Date is set as a result of the fact that all 3,000,000 shares of common stock were not sold on or before September 5, 1972, then upon notice given by the Underwriters or the Company to the Escrow Agent, all of the monies in the Escrow Account shall be refunded in full within twelve business days to the purchasers of the Stock without any payment of interest thereon or any commissions or other deductions therefrom."

12/ During the year preceding the April 26, 1972, effective date of the offering, Bowes had had no contact with any of the proposed underwriters procured by Coven for either version of the proposed public offering (132a, 137a). As noted in the text, he first met a representative of Stevens Jackson at the "due diligence" meeting at Fraunces Tavern. He did not meet a representative of Carlton-Cambridge until the day before the effective date (140a-141a). On that date the staff of the Commission met with representatives of the issuer and underwriters at the Commission's New York Regional Office to review the offering and to stress the underwriters' obligations to assure the suitability of Dennison shares to any prospective purchaser, as well as to work out certain procedures to protect against perceived potential abuses in the after-market. (141a, 217a-218a; 795a-799a.)

(708a-709a, emphasis supplied; see 637a.)

Paragraph 3.01(b) of the underwriting agreement between Dennison the two underwriters, which Coven also prepared (547a-551a), similarly provided:

> "Until said 3,000,000 shares of stock are sold, the Underwriters, shall deposit all funds received with the Republic National Bank . . . in an escrow account."

(See 696a, emphasis supplied). This provision of the underwriting agreement also was described in the prospectus. In addition, the prospectus showed that, of the proceeds of the minimum portion of the offering, the issuer would receive $255,000 and the underwriters would receive $45,000 (15%) for commissions and expenses. The remaining portion of the underwriting was also to generate 15% as commissions and expenses of the underwriters. (724a, 738a.)

B. The Public Offering and the Fraudulent Closing--Coven Certifies to the Bank that the Escrow Can Close because Its Terms Have Been Met when He Has No Basis for the Certification

After the effective date of the offering--April 26, 1972 (Court Ex. 1) --the major selling effort was conducted by Carlton-Cambridge, under the direction of Joseph Rega, the firm's principal, who was intimately involved in all aspects of the distribution (see, e.g. 233a, 248a). 13/ The district court found that the selling tactics of the Carlton-Cambridge registered representatives were "riddled with irregularities" (see 58a). 14/

In spite of the terms of the offering, which required the underwriters' "best efforts" to sell the entire issue, Rega had never intended that Carlton-Cambridge should sell more than one-half of the offering (223a), but, as

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13/ A small selling group was also formed under the aegis of Stevens Jackson (57a-58a).

14/ Among other things, salesmen recommended the stock without determining its suitability for the particular customer (59a) and engaged in unwarranted price projections (59a). In addition, many subscribers never received copies of the prospectus (80a).

the district court found, "embarked on a course of conduct designed to frustrate the goals of the Dennison offering and to use tradings in the Dennison issues for [Carlton-Cambridge's] own financial gain" (79a). To this end, each Carlton-Cambridge office was assigned a maximum number of shares that it could sell (225a-229a; 260a-261a; 56a-57a); and individual allotments were given to salesmen in the firm, which could not be exceeded (386a-387a). On May 29, without regard to Carlton-Cambridge's "best efforts" obligations and without notice to Dennison, it stopped selling the issue (253a-254a; 800a) and commenced trading the stock with the firm's customers at prices from 40 to 70 percent above the public offering price (see pp. 16-17, infra).15/ While Rega claimed, solely on the basis of "indications" and reports from Stevens Jackson, that the minimum had been sold, Rega himself conceded that "indications" are not sales and may be cancelled (230a, 253a-254a; 800a; see also, 61a).

Coven meanwhile prepared for a closing of the minimum portion of the offering on May 30 at Republic National Bank (144a, 421a-423a, 479a-481a, 574a). On that date, however, the balance in the escrow account was only $48,970, some $251,030 short of the $300,000 required for the closing (766a, 770a). After Coven learned this fact, the scheduled closing was cancelled (480a, 486a).

Three days later, on about June 2, however, Republic National Bank was told by Coven or someone in Coven's office, that the minimum had been sold. At this time the bank was provided by Coven wtih a copy of his opinion of counsel, written to the underwriters and dated May 30, 1972, which indicated

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15/ All efforts to sell the new issue by Stevens Jackson also ceased (419a-420a). One member of the small Stevens Jackson selling group, Gotham Securities, however, continued to sell the issue until June 20 (99a (n.5); 331a).

that a closing could be held. (759a-762a; 277a-279a, 284a.) 16/

Another closing was then scheduled for June 5, 1972, but this, too, was cancelled (487a), 17/ since, as Coven knew, the balance in the escrow account was still insufficient (487a), standing at only $73,981 (769a). A third purported closing was scheduled for June 12 at the bank, and, prior to this "closing," on June 7 through June 9, Carlton-Cambridge made deposits of $58,376, $40,000, $23,140 and $28,000, presumably representing funds from its sales of the issue. Carlton-Cambridge's deposits brought the escrow account balance to $223,497. (769a, 776a-780a; 383a-385a.)

Since early May, Coven had been telling Bowes that the minimum 3,000,000 shares had been sold and a closing was imminent (152a-153a). 18/ By the time of the second scheduled closing on June 5, however, Bowes had begun to lose faith in Coven and retained Alfred Greco as his personal representative (146a-148a, 349a).

Greco accompanied Bowes to the June 12 meeting at the bank (349a-350a). Coven, Rega, Levin (underwriter's counsel) and representatives of Republic National Bank and of Stevens Jackson were also present (235a, 286a-287a; 350a; Court Ex. 1, ¶49). Rega arrived with an uncertified Carlton-

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16/ The letter to the underwriters was required by ¶6.06 of the underwriting agreement as a pre-condition to the closing (see 700a-702a). It was required to bear the date of the closing, and was required to state, inter alia, that the corporation was qualified to do business, that the shares to be issued were duly authorized, that the registration statement was accurate, and generally that there had been compliance with state and federal laws (id.).

17/ It appears that these first two "closings" had been scheduled by Coven without the knowledge of the bank (see, 281a).

18/ He had also been saying the same things to Jules Ziffer, the salesman from Stevens Jackson (426a).

Cambridge check for $31,494 (236a, 287a) which, added to the previous amount in the escrow account would have increased it approximately to the $255,000 minimum to be delivered to Dennison. 19/ At the same time, Stevens Jackson deposited $7,506 (286a).

The balance of other funds, plus the amount represented by Stevens Jackson's deposit and represented by Carlton-Cambridge's check, would have brought the escrow account up to $262,497 (Court Ex. 1, ¶58). The bank, however, refused to close until Carlton-Cambridge's uncertified check should clear (287a). In addition, Greco, himself an experienced securities lawyer (see, 363a-364a), protested, on Bowes' behalf, to Coven and Rega, questioning whether it could be determined, consistent with the terms of the escrow agreement, that the minimum had in fact been sold when $300,000 had not been deposited in the escrow account. 20/ As the district court noted, "none of the participants [at] the June 12 'gathering' had any precise idea as to how many shares had been sold." (104a.) "There was bickering, charges, countercharges and even threats of physical force, [that] was hardly conducive to a 'studied consideration' [of the question]." (Id.; see 357a.)

19/ Actually, when Rega's check is added to the balance of $223,497 (769a), the sum is still $9 short of Coven's "net funds" requirement of $255,000.

20/ Greco's protests generated a heated argument with Rega (357a). Greco testified that, on being informed that the escrow account contained less than $300,000, he told Coven, "you cannot close anyway today,...there is not enough Money [sic] in the escrow account" (354a). Coven responded, "We could close net. It is done all the time" (356a). Greco asked how Coven knew all the shares had been sold, stating that "the fact that the escrow does not contain the minimum is a red flag to me, anyway, that the shares may not have been sold" (356a-357a). Indeed, Greco testified that he told Levin, the underwriters' counsel, in Coven's presence "that he better be damned sure if he closes this that those shares are sold." (357a.)

As previously noted, the escrow agreement, which Coven had prepared, expressly provided that $300,000 should be on deposit in the escrow account and that at least the minimum 3,000,000 shares should be sold, before the escrow agent could deliver the proceeds to issuer and pay the underwriters' fees (708a, 766a). At about the time of the aborted May 30 closing, however, Coven had taken the position with the bank that the underwriters could deposit the proceeds of the offering net of their commissions, contending that with the minimum sold the escrow agent would not have to return investor funds and thus was required to have only the net amount due the issuer on deposit--$255,000 (277a, 299a; cf. 791a). 21/

Thus, at the June 12 "closing," when the bank requested assurances that the minimum had been sold and that, in fact, the underwriters had deducted their commissions (236a-238a, 357a), Rega claimed that Carlton-Cambridge had deducted all commissions due it from its last, uncertified check (236a, 289a), and thereupon prepared and signed a letter at the bank (236a-238a), stating that Carlton-Cambridge was due no commissions. But no mention was made of the number of shares Carlton-Cambridge claimed to have sold (788a).

The following day, June 13, Coven wrote a letter to the bank, stating that 3,075,000 shares had been sold, of which 351,000 had been sold by Stevens Jackson (791a; 289a). A letter from Stevens Jackson was also prepared on June 13 stating that it had sold 351,000 shares and that it was due certain commissions (789a; 289a).

On the assumption that the minimum had been sold, a "closing in escrow" was scheduled, that is, pending payment on Carlton-Cambridge's check, stock

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21/ At the June 12 closing, Coven stated that closing "net was "done all the time" (356a).

certificates would be ordered, and the necessary papers prepared. (65a). Coven's June 13 letter, stating that 3,075,000 shares had been sold, was received by the bank on June 14. The letter from Stevens Jackson was received on June 15. (292a-293a, 301a, 640a). 22/

As noted, supra, n.13, Carlton-Cambridge made no representation to the bank as to the number of shares it had sold in its June 12 letter. And although Coven claimed that he had been told by Carlton-Cambridge prior to the June 12 "closing" that the minimum had been sold by the underwriters (479a-481a, 539a), there is no evidence that he sought or was given the number of shares supposedly sold by Carlton-Cambridge. (105a.) Coven suggests that he assumed that documents that were to have been sent to the bank pursuant to ¶ 1 of the escrow agreement by the underwriters, along with each check, giving the names of all purchasers, did in fact reflect that the minimum had been sold (Br. 5; 708a, 766a). 23/ He also stated that he believed that the important factor was that the issuer's share of the proceeds from the offering be on deposit with the escrow agent (624a-625a, 637a) and that, if at the time of the closing the underwriters had "good indications" of interest by customers, whether or not payment had been received, this would be adequate

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22/ No further meetings were held, and on June 21 Republic issued checks to the issuer and those members of the Stevens Jackson underwriting group who represented they were still owed commissions. The minimum portion of the issue was "closed" (294a). One further check, for $1,000, was issued to Dennison on June 27, and the escrow account was apparently closed (Court Ex. 1, ¶65; 769a).

23/ These transmittal letters were evidently not being received by the bank (271a-274a; Court Ex. 1, ¶¶ 52, 53). In fact, Carlton-Cambridge stopped sending its transmittal letters on about May 30. Id.

compliance with the terms of the escrow agreement (634a). 24/ But, as we have previously noted, supra, p. 10, indications of interests are not sales and may be cancelled. Under the circumstances, the number reflected in Coven's letter, 3,075,000 shares, reasonably suggested to the district court, see, infra, p. 22, that Coven had assumed that the closing would be exactly for the minimum, and when Coven then had to account for Stevens Jackson's check for $7,506 produced at the June 12 "closing," he simply added 75,000 shares to 3,000,000 shares to arrive at the figure given in his June 13 letter to the bank. As the district court found, whatever limited grounds Coven may have had for asserting that 3,000,000 shares had been sold, "he had no basis whatsoever for making the categorical representation that exactly 3,075,000 shares had been sold" (106a-107a).

As to how much less than the minimum was actually sold, that is, how many of the shares allegedly sold by Carlton-Cambridge in fact were not sold to bona fide purchasers, 25/ the record is unclear--in part, because Carlton-Cambridge's records "were transferred to a basement in Lodi, New Jersey" (99a n.7), and mysteriously destroyed in a flood in December 1972 (see 81a).

Nevertheless, on June 15, when Carlton-Cambridge requisitioned stock certificates representing 2,724,000 new issue shares from the transfer agent

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24/ Apparently, Coven was told by Levin that both of the earlier scheduled closings should be put off because of collection difficulties encountered by the underwriters (481a, 484a-485a, 488a). These difficulties supposedly related to cancellation of purchases or difficulties in clearing customer checks (540a-542a).

25/ Pl. Ex. 35 (800a-802a), which is Carlton-Cambridge's weekly record of indications for the Dennison offering, shows that the firm recorded only indications for 2,800,000 shares by June 12.

(807a), 26/ it ordered certificates to be issued in customers' names representing only 1,723,855 of these shares (id.). The balance of 1,000,145 shares were ordered in street name (id.). This suggests, as found by the district judge (see infra, p. 22 n.36), that Carlton-Cambridge derived its figure for the number of shares it had purportedly sold as part of the public offering, not from the facts, but merely by subtracting the amount that Stevens Jackson said it had sold from the figure (3,075,000) posited by Coven in his letter to the bank (see, supra, p. 14). 27/ Under these circumstances, the district court properly concluded that Carlton-Cambridge's figures were contrived, that the minimum portion of the offering had not, in fact, been sold, and that Coven had no basis for concluding and representing that the issue could be closed (88a; 102a). 28/

C. The Deliberate Failure to Sell the Remaining Portion of the Issue and the Beginning of the Market Manipulation--of which Coven Was on Notice

At the purported closing on June 12, Coven assured Bowes that the entire issue of 6,000,000 shares would be sold (157a-158a, 359a-361a, 517a).

As noted above (p. 10), however, on May 29 Carlton-Cambridge had already stopped selling the Dennison issue and on June 2 had commenced trading

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26/ This is the difference between Coven's total sales figure of 3,075,000 shares and the sales by Stevens Jackson of 351,000 shares.

27/ In view of Carlton-Cambridge's previously commenced trading position, which by June 12 had resulted in a 268,7000 share "short" position in Dennison stock, it appears that some of the street name shares would have been used to cover its position (see 803a-806a; see also, supra p. 10).

28/ The district court buttressed its view of Coven's cavalier approach (88a) by the fact that on or about June 20, Coven received notice that only 3,073,500 shares had been issued by the transfer agent (626a-632a) but there is no indication in the record that he ever questioned the 1,500 share discrepancy (see 89a).

the shares with its customers at prices above the new issue price. 29/ Before that date, Coven informed Lian, a trader at Stevens Jackson, that M. S. Wien, a registered broker-dealer and over-the-counter marketmaker, was going to enter a quotation in the "pink sheets" for Dennison on June 1 or June 2 "to assist in the sale of [Dennison] because it was close to closing" (309a, 310a-311a, 320a; 112a-113a). And, in fact, on June 5, M. S. Wein appeared in the "sheets," at the behest of Rega, after receiving assurances from Rega that the deal had been closed and the stock could be traded (370a-371a, 375a). Preston Morris, a trader at M. S. Wien, testified that his quotations were for a regular market (379a-380a.) In fact he sold short 37,000 shares on June 5 at 14-1/2 cents and partially covered this position the next day by a purchase of 20,000 shares at 13 cents from Carlton-Cambridge (815a-820a; 376a-377a).

Bowes did not learn until late July that the underwriters were not continuing to use their "best efforts" to sell the issue (168a-169a). 30/ At that time he telephoned Coven and asked if Coven knew the stock was being traded. Coven claimed ignorance and promised to look into the matter (170a). Coven states that he made no attempt to monitor the second portion of

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29/ By June 21 the firm had sold 435,750 shares and purchased 95,000; its net position was therefore short 340,750 shares. Sales were made at prices up to seventeen cents per share (803a-806a).

Rega's trading at manipulated prices continued for another year (74a-75a). Eventually Rega "boosted" the price to 70 cents per share (75a).

30/ He was misled on this point by oral assurances from Rega and a letter from Carlton-Cambridge in mid-July (165a-166a; 765a). Coven testified that he had left a message at Bowes' office informing Bowes at the end of June (526a) that the issue had to be deregistered, not that selling had stopped. See also n.32, infra.

the Dennison offering (611a-613a), because he was "busy on another issue" (612a).

From June 1 to 18, however, Coven was in frequent contact with Rega and Carlton-Cambridge (611a-612a, 677a). During this period, when the underwriters were supposed to be using their "best efforts" to sell the balance of the Dennison issue, Coven appeared as counsel to the firm of Stevens Jackson in negotiations to accomplish a merger between Stevens Jackson and Carlton-Cambridge--merger negotiations necessitated by Stevens Jackson's impaired financial condition (243a, 245a, 313a, 574a, 592a). A merger agreement was signed on June 8 (202a; 808a-814a) in Coven's office (239a, 243a). There is no indication that Dennison or its president, Bowes, was ever advised of these merger negotiations (see, 247a). Testimony showed, moreover, that no mention of this was made at the June 12 "closing" (246a-247a). 31/ In addition, during July, Coven, although purportedly "angry" with Rega over the failure to sell the maximum and the trading by Carlton-Cambridge (646a), worked as counsel for another issuer on a new underwriting with Carlton-Cambridge (652a-654a). On July 18, 1972, the Dennison offering was deregistered (747a-749a). 32/

31/ No amendment to the registration statement or the prospectus was made to reflect this change in the underwriting of the second half of the issue (see Pl. Ex. 1). Cf. Securities and Exchange Commission v. Manor Nursing Centers, supra, 458 F.2d at 1095.

32/ The chronology of the deregistration is confused in the record with only two dates appearing certain—(a) July 11, 1972, the date of two letters from Carlton-Cambridge to Bowes, one of which contains the statement: "In view of the fact that the best efforts portion of your issue is to remain open ..." and the other of which is an agreement to extend the time for completion of the offering (764a, 765a); and (b) July 18, 1972, the date the Commission deregistered the remaining securities, (747a-749a). The required amendment (see Commission Rule 478, 17 CFR 230.478) to the registration statement for such deregistration

(continued)

As reflected in the prospectus and the Dennison registration statement, as well as in Bowes' testimony, the underwriters' failure to sell the maximum portion of the offering would and did result in a curtailment of the company's expansion plans (715a, 726a, 728a; 177a). The manipulation of Dennison's stock, commenced by Rega at Carlton-Cambridge even prior to the closing of the minimum portion of the public offering, continued until the end of 1973 (see n.29 supra).

2. Opinions Below

In its first opinion, dated June 30, 1975, the district court found defendants Rega and Carlton-Cambridge to have been engaged in a scheme to defraud public investors and the issuer (79a):

> "From the very beginning of this Dennison public offering Rega and Carlton embarked on a course of conduct designed to frustrate the goals of the Dennison offering and to use tradings in the Dennison issues for their own financial gain." (79a). 33/

This design and the deliberate failure of the second underwriter, Stevens Jackson, to expend much effort 34/, the court found, imposed "serious

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32/ (continued)
was signed by Bowes. (749a.) Bowes testified, however, that he did not learn that the maximum had not been sold until informed by Rega at a meeting in Coven's office at which Coven was not present in late July or early August (168a, 172a-174a). Rega's testimony confirms such a meeting on that date (250a). Bowes' explanation of the inconsistency between his signature on the amendment to the registration statement, which was dated July 18, and his lack of knowledge prior to the later meeting with Rega is that he probably signed the document in blank (181a, 183a), or without an opportunity to read it -- a not uncommon procedure with Coven. See n.7, supra. His explanation is consistent, moreover with his testimony that he did not find out the stock was being traded until late July or early August (169a-170a).

33/ As noted, supra, p. 9, with respect to the shares it did sell in the public offering, Carlton-Cambridge's selling tactics in dealing with its retail customers were found to be "riddled with irregularities" (58a).

34/ A Stevens Jackson salesman described the firm's selling effort as minimal (307a-308a).

undisclosed limitations . . . on the handling of the offering" (58a).

The district court also found that Rega deliberately and secretly stopped his firm's sales efforts on May 29, 1972, without evidence that even the minimum 3,000,000 share portion had been sold, whether in the form of confirmations or by the balance of funds on deposit in the escrow account (61a). Indeed, at that time the escrow account contained only $48,970. 35/

The district court concluded: "A crucial element to Rega's scheme was to make it appear that the minimum had been sold" (88a), and "Coven's understanding attitude and his lack of concern in establishing that the minimum had been sold was very helpful to Rega" (id.). The district court noted that Coven's assistance "did not stop there" (id.). Rather,

> "[i]n response to the inquiries by [the bank], he represented that 3,075,000 shares had been sold. Coven had no basis whatsoever to make this representation and in fact his figures were erroneous at that."

(88a-89a.)

In the district court's view, Coven's sudden loss of interest in the Dennison offering subsequent to the June 12 "closing" and his failure to keep himself informed of the progress of the maximum portion of the offering was inexplicable (90a-91a). The court noted that prior to the June 12 "closing" Coven had been in frequent contact with underwriters' counsel, Levin, and with the underwriters themselves (id.), and the court was not convinced by Coven's explanation that subsequent to the June 12 "closing" he had "more important matters" to deal with (90a).

35/ As the court's opinion makes clear (61a, 81a-82a), the escrow account balance was significant in determining how many shares had in fact been sold. At the time the aborted May 30 closing was "confidently being prepared for," Rega had only indications for 2,760,000 shares (61a). But indications are not sales--they may be cancelled by the investors (see, p. 10, supra; 230a; 61a).

The court also found that Coven "facilitated" violations of Commission Rule 10b-6 by Carlton-Cambridge and Rega when, with prior knowledge that M. S. Wein would appear in the "pink sheets" as a marketmaker in Dennison stock, he failed to make "the slightest effort to look into the circumstances surrounding M. S. Wien's market" (91a).

Based on these findings of fact, and applying the test enunciated by this Court in Securities and Exchange Commission v. Management Dynamics, 515 F. 2d 801, 811 (1975), that is, "whether the 'defendant should have been able to conclude that his act was likely to be in furtherance of illegal activity'" (87a), the district judge held that Coven had aided and abetted Carlton-Cambridge's and Rega's violations by:

(1) permitting the escrow deposits to be made "net" (88a);

(2) permitting the minimum portion of the offering to close without the required $300,000 on deposit in the escrow account (id.);

(3) representing that exactly 3,075,000 shares had been sold when he had "no basis whatsoever" for the statement (id.);

(4) his "inaction" and "disinterest" in learning whether the maximum portion of the offering had been sold (90a-91a); and

(5) his apparent oblivion to the import of M. S. Wien's entering quotations for Dennison stock in the "pink sheets" (91a).

Having found that Coven violated antifraud and anti-manipulation provisions of the federal securities laws, the district court concluded that "there is a reasonable expectation that [he] will continue to engage in similar violations" (98a) and granted the injunctive relief requested by the Commission.

On Coven's motion to reconsider, the district court reaffirmed and amplified its earlier findings. The court rejected various contentions advanced by Coven in an attempt to show that his representations about the

number of shares that had been sold by the underwriters were accurate. (103a-107a 108a-109a, particularly 105a n.3.) In this regard, the court reiterated that the escrow and underwriting agreements required that the gross proceeds of the Dennison offering be on deposit prior to closing (103a, 105a-107a). Further, in the court's view, Coven's admitted focus on the money due his client and "Coven's preconception that all that was essential was for the escrow account to have sufficient funds to pay the issuer" provided the real reason for Coven's unjustified representation to the bank that exactly 3,075,000 shares had been sold and his acquiescence in the closing (104a). Moreover, the district court rejected Coven's contention that his representation to the bank that exactly 3,075,000 shares had been sold was consistent with the record, noting that "Coven's current explanation as to how he reached the 3,075,000 figure differs markedly from his testimony at trial" (105a). Although apparently Coven had been told that the Stevens Jackson firm had sold 351,000 shares, the court found no evidence "that he was told by anyone the exact number of shares that Carlton" had sold (id.). The court found that "it was thought [at least by Dennison's president and Stevens Jackson's representative] the closing scheduled was for exactly the minimum" (106a), and stated that "this would explain Coven's own concern that the escrow account reflect at least $255,000--the amount due to the issuer if the [minimum] had been sold" (105a-106a). Accordingly, when the Stevens Jackson check for an additional $7,506 was tendered at the June 12 "closing," Coven merely added 75,000 shares to his count and represented to the Bank that 3,075,000 shares had been sold (106a). 36/ Thus, the lower court found Coven had "no basis whatsoever for

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36/ The district court observed that Rega apparently ordered delivery of exactly enough shares to make the amount consistent with Coven's representations (109a):

(continued)

making the categorical representation that exactly 3,075,000 shares had been sold." (106a-107a).

The court emphasized that Coven's "indifferent attitude and disinterest" regarding the sale of the maximum portion of the issue was unacceptable for the drafter of the underwriting agreement who was the attorney for the issuer and was in frequent contact with Rega at Carlton-Cambridge during the period when the maximum was to have been sold (110a).

Finally, the district court refused to retreat from its conclusion that Coven had aided and abetted Rega's and Carlton-Cambridge's Rule 10b-6 violations when he failed to take action, much less to make inquiries, when confronted with M. S. Wien's commencement of trading in Dennison stock. He reemphasized Coven's prior knowledge that Wien would appear in the pink sheets (114a) and the lack of a sufficient basis for Coven's assertion that he could properly have concluded that Wien could only be making a market on a "when as and if issued" basis (id.).

The court found (115a-116a):

> "Coven was not just a minor actor in the events surrounding the distribution of the Dennison issue who was misled by other wrongdoers. Rather he provided the impetus for the launching of the issue. He drafted the pertinent documents as counsel for the issuer and sought out the underwriters and the escrow agent. It was to him that the issuer and at least one of the underwriters (Stevens) consistently turned for information respecting the Dennison distribution. In this respect it is noteworthy and significant that although another attorney was supposedly acting as counsel for Stevens when problems arose or questions concerning Dennison had to be answered Stevens looked to Coven for

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(continued)

> "[T]he inference is inescapable that Rega was aware of Coven's representation. Otherwise, it is difficult to explain how Rega's odd number of certificates to be issued in 'street name,' 1,000,145 shares, coincidentally matched the exact figure to total Coven's estimate of 3,075,000 shares."

guidance. Further, it was in part to Coven that the bank turned for some assurance that the minimum had been sold. In short, Coven played a key role in the Dennison distribution.

"Yet despite this Coven displayed very little if any sensitivity to his responsibilities. He was oblivious to the number of red flags along the way indicating that something was amiss with the Dennison issue. The fact that the escrow account did not have the correct amount of funds, that M. S. Wien was trading the stock and to use Coven's own words possibly 'pirating' the issue, that he had no precise idea as to the number of shares sold, that his estimate had proven to be erroneous - all this and more was ignored by Coven."

It concluded:

"Even when admittedly Coven became aware of Rega's misdeeds, his actions reflected little dismay at what had transpired. Though he professed to be 'angry' at Rega, shortly thereafter he embarked on a new issue with Carlton as the underwriter."

Id.

On this basis the district court affirmed its findings of violations and its decision to issue a permanent injunction against Coven.

SUMMARY OF ARGUMENT

The imposition of liability, in this action by the Commission to enforce the federal securities laws, for aiding and abetting fraud was proper. The record below amply shows that Coven acted recklessly, in disregard of obligations imposed upon him under the federal securities laws and his responsibilities as a member of the bar.

Coven argues, however, for the application of an erroneous definition of what constitutes aiding and abetting. He then contends, also erroneously, that his reckless and negligent violative conduct is not a sufficient predicate for the entry of an injunction. This is an unwarranted attempt to extend to Commission enforcement actions the Supreme Court's decision in Ernst & Ernst v. Hochfelder, 37/ where completely different considerations are applicable than to those applicable to private actions for damages. It also ignores the fact that the instant case was based not only upon the general antifraud provisions of Rule 10b-5 and Section 10(b) of the Securities Exchange Act of 1934, but also upon specific anti-manipulation rules pursuant to that section, as well as upon the statutory antifraud proscriptions contained in the Securities Act of 1933--provisions not involved and not construed by the Court in Hochfelder.

The district court considered but correctly disregarded Coven's contentions, repeated before this Court, that whatever he did, even if wrong, was a temporary lapse. The district court recognized that the facts of

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37/ 425 U.S. 185 (1976).

this case show a consistent pattern of such lapses in the offering of Dennison's securities. Coven adds the suggestion that he has since reformed, and complains that the court below ignored his representations to that effect. Yet he in turn ignores the fact relied upon by the district court that immediately after discovering that Rega and Carlton-Cambridge had failed in their obligations to his client, Dennison, he launched into another public offering with Rega.

Finally, Coven relies on his status as a member of the bar as a mitigating factor. He asserts that this Court should reverse the district court's exercise of its discretion in entering the injunction and strike a different balance, due to the weight that should purportedly be given to the negative effect of an injunction upon the professional standing of an attorney. These contentions disregard the import of the teachings of this Court that, to the contrary, an attorney's position in society and his key role in the securities markets require more careful scrutiny of his conduct:

> "In our complex society the accountant's certificate and the lawyers's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar . . . Congress . . . could not have intended that men holding themselves out as members of these ancient professions should be able to escape criminal liability on a plea of ignorance when they have shut their eyes to what was plainly to be seen or have represented a knowledge they knew they did not possess."

United States v. Benjamin, 328 F. 2d 854, 863 (C.A. 2), certiorari denied sub nom. Howard v. United States, 377 U.S. 953 (1964).

ARGUMENT

I. COVEN'S CONDUCT UNLAWFULLY FACILITATED THE MULTIPLE FRAUDS PERPETRATED BY REGA AND CARLTON-CAMBRIDGE

A. The Failure to Sell the Minimum and Fraudulent Disbursement of Funds From the Escrow Account--Section 17(a), Rules 10b-5 and 10b-9.

The Commission charged in its complaint and the district court found that the underwriters failed to satisfy the "all or none" conditions of the first portion of the Dennison offering. In other words, the underwriters had agreed in the escrow agreement and represented in the registration statement that unless $300,000 should be placed in the escrow account from the sale of 3,000,000 shares of Dennison stock on the delivery date (i.e., the time of closing), 38/ all of the money received would be returned to the investors. Despite the fact that the balance in the escrow account never reached $300,000, and the fact that all of the 3,000,000 shares were not sold in bona fide transactions, the sums received were not returned to investors. Accordingly, there was a violation of the specific terms of Rule 10b-9, as well as of the general antifraud provisions contained in Section 17(a) of the Securities Act and in Rule 10b-5. Commission Rules 10b-5 and 10b-9 implement Section 10(b) of the Securities Exchange Act.

Rule 10b-9, specifically provides: "It shall constitute 'a manipulative or deceptive device or contrivance' as used in Section 10(b) of the [Securities Exchange] Act, for any person, directly or indirectly, in connection with the offer or sale of any security, to make any representation . . ." that a security is being sold on an "all or none" basis, unless the consideration will promptly be refunded if the specified number of the

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38/ Or if there had been no closing, the agreement provided that the $300,000 must have been deposited on or before September 5, 1972. (See p. 8, supra.)

securities is not sold within the specified time. The rule thus made unlawful the failure to return investor funds in this "all or none" offering where the minimum was not in fact sold. The violation of the specific provisions of Rule 10b-9, as the district court recognized (80a-81a), also falls within the general anti-fraud proscription of Section 17(a) and Rule 10b-5. See Securities and Exchange Commission v. Manor Nursing Centers, Inc., 458 F.2d 1082, 1084, 1095 (C.A. 2, 1972). 39/

Coven argues (Br. 9) that there is no basis for the district court's conclusion that the minimum was not sold. It is not sufficient, however, to suggest, as Coven does (Br. 3-5, 9), that because the underwriters ordered shares in excess of the minimum the issue had been sold or that Coven had a sufficient basis under the circumstances to believe it had been sold. As the Commission recently stated, the bare fact that more than the minimum number of shares is transferred does not satisfy the rule:

> "[U]nder Rule 10b-9, an offering may not be considered 'sold' for the purposes of the representation 'all or none' unless all the securities required to be placed are sold in bona fide transactions and are fully paid for. It is clearly contrary to the intent and purpose of the rule to declare an offering all sold, for the purposes of the 'all or none' conditions . . . on the basis of non-bona fide sales designed to create the appearance of a successful completion of the offering, such as purchases by the issuer through nominee accounts."

Securities Exchange Act Release No. 11532, July 11, 1975, 7 SEC Docket 401, 403 (July 29, 1975) (emphasis supplied). See also Securities and Exchange Commission v. Manor Nursing Centers, supra, 458 F.2d at 1095.

39/ The full texts of Section 17(a) and Rules 10b-5 and 10b-9 appear in the Statutory Appendix, infra.

As stated, supra, p. 3, n.2, the Commissions's allegations against Coven were premised on the antifraud provisions of both Section 17(a) of the Securities Act and Rule 10b-5 promulgated under the Securities Exchange Act. Neither the lower court's findings (87a, 115a-117a) nor the injunction entered (43a-51a) differentiates between the two.

The record below supports the district court's inference that some of the street name shares requisitioned by Carlton-Cambridge were for Carlton-Cambridge's account and did not represent bona fide sales, see pp. 21-22, supra, cf., 66a, 100a-109a. 40/ In this regard, the district court correctly stressed the fact that Carlton-Cambridge had stopped selling the issue at a time when, according to Rega's testimony, he had indications only for more than the minimum number of shares (109a). When this Commission proposed Rule 10b-9 it stated that one of the Rule's purposes was to prevent the practice of closing what purports to be "all or none" offerings on the basis of indications of interest: 41/

40/ Coven attempts (Br. 9) to cast doubt on the district court's conclusions with respect to the contrived nature of Carlton-Cambridge's requisition of exactly 1,000,145 shares in street name by relying on the terstimony fo Marie Kolano. Ms. Kolano was the synidcation manager at Carlton-Cambridge, who prepared the firm's letter to the transfer agent requisitioning the Dennison shares (807a). Coven asserts that her testimony shows that the street-name shares were for the accounts of bona fide purchasers. These contentions are not supported on the record. She testified (405a-409a) that the names of certain Dennison shareholders did not appear on the list of purchasers sent to the transfer agent by Carlton-Cambridge. She did not, however, identify all or any significant number of persons who held shares in street name and did not testify that all or any particular number of such shares belonged to bona fide purchasers (id.).

Ms. Kolano's testimony (391a-393a) to the effect that all confirmations were stamped "Paid" and that Rega did not add shares to be placed in street name to make up the difference between shares to be issued in the names of identified customers and the number chosen by Coven is equivocal and was justifiably disbelieved by the district court (66a; 10?a). She conceded that Rega told her the number of shares to be placed in street name (395a; 396a). She admitted, moreover, that she did not clearly remember the Dennison issue (406a), counting the confi.mations (392a, 396a) or whether she counted them all herself or had sought assistance from someone else in the firm (391a, 398a-399a). Her testimony appears to have been based on little more than conjecture (see, e.g., 401a, 403a, 406a).

41/ Such a practice effectively converts an "all or none" offering into a mere "best efforts" underwriting. Weiss, Registration and Regulation of Brokers and Dealers, supra, at 118-119.

> "It has come to the attention of the Commission that some persons distributing securities have been representing that securities are being offered on an 'all-or-none' basis when, because of ambiguities in the contractual arrangement, it is not clear whether the conditions have been met if the underwriter finds persons who agree to purchase all of the securities within the specified time, but he is unsuccessful in collecting payment on all of the securities."

Securities Exchange Act Release No. 6864 (July 30, 1962), 27 F.R. 7684 (August 3, 1962). 42/

No such ambiguity existed in this offering. (55a-56a). Not only did the prospectus and the underlying documents require that the minimum actually be sold, paragraph 2(d) of Coven's escrow agreement unmistakably required that the gross amount from those sales be on deposit in the escrow account (see supra, p. 8). That escrow account never contained the requisite funds.

Coven's assertion that at the June 12 closing he properly construed the agreements merely to require that the requisite number of shares had been sold (Br. 3-5, 27) was rejected when presented to the district court as a matter of construction (102a) and is inconsistent with his testimony at trial, where he stated that an "all or none issue" might close whether or not the funds are in hand, solely on the basis of "good indications" (634a).

In fact Coven's suggestion that he was properly concerned only that the issuer corporation should receive its money (Br. 4, 6, 25) highlights the importance of the provision of paragraph 2(d) of the escrow agreement. In Lewisohn Copper Corp., 38 S.E.C. 226, 232 (1958), the Commission stated:

42/ The rule was subsequently adopted without a relevant change. Securities Exchange Act Release No. 6905 (October 3, 1962), 27 F.R. 9943 (October 10, 1962).

> "We cannot accept the contention . . . that it was immaterial to investors that there were cancellations and refusals of delivery . . . because the main concern of an investor was [assertedly] whether the Company would receive [the maximum possible proceeds of the offering].
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> "Representations with respect to the public demand for and acceptance of securities publicly offered are highly material since they bear directly on investment attractiveness of the securities and tend to affect the judgment of investors concerning them.

See also, Securities and Exchange Commission v. Manor Nursing Centers, supra, 458 F.2d at 1095.

Other financial concerns also depended upon the closing of the minimum. At trial Coven conceded a substantial financial interest in a successful underwriting (552a-553a). When Bowes first retained Coven in June of 1971 to arrange a public offering he retained Coven for this purpose at a total fee of $25,000--$5,000 payable upon signing of the retainer and the balance payable "pro rata" from the proceeds of the then-anticipated 120,000 share offering (see n.6, supra) at the rate of twenty cents per share sold (821a-823a). On April 13, 1972, two weeks before the effective date of the offering, a new retainer agreement was demanded by Coven (135a). This revised the fee upwards $5,000, to a total of $30,000 (756a-758a). Under the new agreement $5,000 was payable at the time it was signed, but the next $20,000 was payable out of the proceeds from, and at the time of, the completion of sale of the minimum portion of the offering (id.). This left a balance of $5,000 due after that, and this amount was due upon the sale of the next $100,000 worth of shares (id.).

Coven's erroneous legal conclusions were compounded by continual factual lapses. At the trial Coven testified that he was in frequent contact with counsel for the underwriters (see supra, pp. 15 n.24, 18), following

the progress of the offering until mid-June 1972, when the minimum portion of the issue closed; and, as we have seen, almost immediately after the offering commenced he had begun assuring Bowes that the issue had been sold and a closing was imminent (supra, p. 11). Shortly after May 30 he advised the bank that the minimum had been sold and sent the bank a copy of his opinion letter which authorized a closing (759a-762a). 43/

Nevertheless on two occasions the minimum closing could not be held because of insufficient funds in the escrow account. On June 12, when Coven attempted for the third time to have a closing, both he and Levin were warned by Bowes' personal attorney, who was himself an experienced securities practitioner (supra, p. 12), that there was doubt that the minimum number of shares had been sold, because the escrow account still did not contain the $300,000 called for by the escrow agreement. (See n.20, supra.) The bank, not having received enough money, agreed to a later "closing in escrow" but required written assurance from Coven that the minimum number of shares had in fact been sold and that the underwriters had deposited net funds.

The court found that Coven did not take any action to verify the number of asserted sales (105a-106a). And the effect of his net-funds position was to make precise calculation extremely difficult (cf., 106a). Nonetheless by letter dated June 13, Coven gave the bank his assurances, stating that 3,075,000 shares had been sold.

Prior to the June 12 closing, Coven had evidently assumed that the closing would be for exactly the minimum number of shares (supra, p. 22). On this assumption, Coven concluded and represented unequivocally to the

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43/ See supra, pp. 10-11.

bank that exactly 3,075,000 shares had been sold (791a). The appearance of the Stevens Jackson check for $7,506 at the closing merely made it necessary to account for an additional 75,000 shares. And as the district court noted (see supra, n.36), it was apparent that Rega ordered exactly enough shares from the transfer agent three days later by adjusting the number of shares to be placed in street name to total the difference between Coven's figure and the number of shares sold by the Stevens Jackson selling group. 44/

The repeated representations of this experienced securities lawyer that the minimum had been sold, which began within a week of the commencement of the offering; the consistent position that the underwriters could deposit their funds "net," which was first articulated just after the scheduled May 30 "closing" had to be cancelled due to insufficient funds in the escrow account; and, finally, his June 13 opinion letter, formalizing these positions, reassured the bank and assisted Carlton-Cambridge in obtaining a closing of the issue without its having to account for its supposed sales. 45/

44/ Coven appears to argue (Br. 25-26) that he justifiably relied upon the bank's subsequent count of the share certificates requisitioned by the underwriters as an adequate check on his letter of June 13. By then, however, the damage had been done. Carlton-Cambridge evidently needed to have a closing of the minimum portion of the issue so that it could cover its accumulating short trading position (see, supra, n.27). In fact, although Coven asserts (Br. 26) that he "had obtained his figures from the underwriters," it does not appear that, prior to its June 15 requisition, Carlton-Cambridge told anyone involved how many shares it had supposedly sold. Its letter to the bank stated only that it was due no commissions. Coven's letter therefore apparently provided Carlton-Cambridge with enough information to know how many shares to order. The difference between Coven's figure was easily made up in the street name shares (see 66a and 109a).

45/ Coven states (Br. 27) that the record does not show that he informed the bank in early June that subscribers' funds would be deposited net. Although he quotes from the testimony of a bank official at 277a, he does not refer this Court to the preceding exchange of question and answer, where the official agrees that he was told that funds would be deposited net.

Consequently, Carlton-Cambridge was presumably able to cover its accumulating short trading position. In fact, Coven's net funds opinion must have been helpful to Carlton-Cambridge's cash position.

B. The Failure To Sell the Maximum Portion of the Issue--Rule 10b-5, Section 17(a)

As described previously (pp. 9-10, supra), on May 29, 1972, Carlton-Cambridge, through Rega, decided that 3,000,000 shares had been sold or otherwise accounted for and in effect terminated the public offering, making no effort at all, much less the "best efforts" required by its underwriting agreement and represented to the public in the registration statement and the prospectus, to distribute the remaining 3,000,000 shares of Dennison securities. The district court found that Carlton-Cambridge's action, unilaterally ending the public offering, violated Section 17(a) and Commission Rule 10b-5, constituting a fraud on both the issuer and the investing public (supra, pp. 19-20).

Coven argues that he has no responsibility for the failure of Carlton-Cambridge to have continued the offering (Br. 15-16). But Coven, the expert securities lawyer (supra, p. 5), who orchestrated the offering, by preparing the documents (supra, pp. 8-9), by locating the principals (supra, pp. 5-7), by remaining in contact with the underwriters (supra, pp. 14, 15 n.24), by scheduling the repeated closings (supra, pp. 10-11), and by issuing various opinion letters (supra, pp. 10-11, 13), and who was engaged in negotiating a merger agreement between the two underwriters during the time the maximum number was supposedly being sold (supra, p. 18), apparently was not believed by the court below (110a) when he represented, as he does to this Court (Br. 13-14), that he never even inquired about the course of the second half of the offering.

And mere inquiry would have revealed that his client was not receiving funds from the additional sales that the underwriters' best efforts were to have produced. While the escrow agreement is unclear whether funds from the maximum portion of the offering were to be deposited in the escrow account (see 708a-709a), Commission Rule 15c2-4, 17 CFR 240.15c2-4, has required since 1962 46/ that all funds from any underwriting be "promptly transmitted to the persons entitled thereto." Under the circumstances, the district court properly held that Coven should have known that the underwriters had ceased any efforts to continue the offering (110a).

In fact, when in late June, Coven concededly became aware that Carlton-Cambridge was trading the stock, he concluded that the offering was over (Br. 20-21; 109a). He then waited until July 18 to deregister the stock (supra, p. 18) and embarked on preparations with Rega for another public offering which Carlton-Cambridge was to underwrite (116a-117a).

In the totality of these circumstances, Coven may not be permitted to "close . . . his eyes to facts he had a duty to see." United States v. Benjamin, supra, 328 F.2d at 862. 47/

C. Coven's Complete "Oblivion" to Violations of Rule 10b-6.

In its opinion denying Coven's motion for reconsideration, the district court concluded that ". . . Coven played a key role in the Dennison

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46/ See Securities Exchange Act Release No. 6737 (Feb. 21, 1962), 27 F.R. 2089 (March 3, 1962).

47/ See also, Securities and Exchange Commission v. Management Dynamics, supra, 515 F.2d at 811.

distribution" but

> "displayed very little if any sensitivity to his responsibilities. He was oblivious to the number of red flags . . . indicating that something was amiss with the Dennison issue" (116a).

Significant among the red flags which Coven ignored was the appearance of M. S. Wien in the market. (See pages 16-17, supra.)

Coven argues (Br. 18-20) that M. S. Wien's appearance in the "sheets" was legal and, therefore, Coven had no obligation to inquire. This argument is beside the point. M. S. Wien's actions may have been completely legal--and the Commission made no allegations against the firm--but Rega's action in inducing M. S. Wien to make a market clearly was not. Commission Rule 10b-6 makes it unlawful for any person

> "(1) Who is an underwriter or prospective underwriter in a particular distribution of securities, or
>
> "(2) Who is the issuer or other person on whose behalf such a distribution is being made, or
>
> "(3) Who is a broker, dealer, or other person who has agreed to participate or is participating in such a distribution, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, either alone or with one or more other persons, to bid for or purchase for any account in which he has a beneficial interest, any security which is the subject of such distribution, or any security of the same class and series, or any right to purchase any such security, or to attempt to induce any person to purchase any such security or right, until after he has completed his participation in such distribution." (Emphasis supplied.) 48/

48/ Several exceptions, not applicable here, to this blanket prohibition follow in the Rule. See Statutory Appendix, infra.

Coven does not dispute that the Rule was violated by Rega insofar as Rega induced M. S. Wien to begin trading, nor could he. See Securities and Exchange Commission v. Scott Taylor, 183 F. Supp. 904, 908 (S.D. N.Y., 1959). There the court found a violation by certain brokers

(continued)

Nonetheless, in support of his position, Coven asserts (Br. 20) that when he found out that M. S. Wien had placed a bid in the pink sheets he properly assumed M. S. Wien's trading to be legal because such trading could only be on a "when as and if issued" basis. 49/

The point is, however, that it is unlawful for an underwriter to induce anyone to make a bid for a security under Rule 10b-6. It is not relevant, in our view, that M. S. Wien could or might have been making a "when issued" market as opposed to a regular market (see Br. 22-23). The only relevant distinction between a "when issued" bid and a regular bid is that a contract pursuant to the former is cancellable. CCH, NASD Manual ¶¶ 3501, 3504.10. A "when issued" bid would, just like any other bid for the stock, tend to support the market, and would in the circumstances have a comparable manipulative effect.

48/ (continued)

engaged in a distribution who caused bids to be placed in the pink sheets by another broker, noting that their action fell within the proscription of the Rule against placing bids "directly or indirectly . . . either alone or with one or more persons."

49/ He attempts to bolster this argument by stating, "The Commission who [sic] noted the appearance saw no reason to make any inquiries" (Br. 20). Coven is evidently referring to the testimony of Steven J. Glusband, the Commission investigator who monitored the Dennison issue, at 222a, in that Glusband made clear that the "mere" appearance of the stock in the pink sheets does not prove a violation --and that there could be "when issued trading" (emphasis supplied). However, Coven ignores Glusband's other testimony, where the investigator related that he became concerned by the appearance of M. S. Wien in the pink sheets before he had received a report that even the minimum had been sold (414a). Shortly thereafter Glusband commenced inquiries of broker-dealers (414a-415a) and by mid-July (219a) the Commission had commenced a formal investigatgion (416a-418).

Coven seems to say that in any event he, as attorney for the issuer, had no obligation to investigate when he was informed that M. S. Wien already had started to make a market in the stock (Br. 20-21). 50/ Testimony at trial however suggests that he knew in advance and that he knew the purpose for M.S. Wien's appearance. Testifying about a telephone conversation with Coven, Philip Lian, the trader at Stevens Jackson, stated with regard to M. S. Wien:

> "I recall [Coven] saying that to assist in the sale of the security because it was close to closing, that it [the security] was going to appear in the pink sheets
>
> * * *
>
> He [Coven] said the brokerage firm of M.S. Wien & Company would be making a market in the stock."

310a-311a (emphasis added). 51/ Such "assistance" is the very evil Rule 10b-6 was designed to combat. See, Securities and Exchange Commission v. Scott Taylor & Co., 183 F. Supp. 904, 907 (S.D. N.Y., 1959) ("unjustifiable impression of market activity which would facilitate the sale.")

Although Coven disputes the accuracy of Lian's recollection that it was Coven who told him the market-maker would appear in the pink sheets (Br. 23-24), the district judge, who heard the testimony, rejected the contention (113a). The court's conclusion is not "clearly erroneous," and hence should not be disturbed on appeal. See, Zenith Corp. v. Hazeltine, 395 U.S. 100, 123

50/ At least M.S. Wien had checked with Rega in an attempt to assure itself that the offering had closed, and was misled (see supra, p. 17). As the district court noted with respect to the best efforts violations, had Coven done anything similar the court's conclusion might have been different. (110a)

51/ In fact, there is some suggestion from the testimony regarding that telephone call that Coven was also trying to induce Stevens Jackson to begin trading the stock (312a).

(1969). 52/

Coven makes a further argument of legal impossibility. He asserts that he could not have aided and abetted a violation of Rule 10b-6 where the violation was complete before he knew of it (Br. 10, 20-21). In this connection, he misperceives the scope of the Rule.

Coven seems to argue that once Carlton-Cambridge had stopped selling the new issue shares, its participation in the "distribution" had been completed and that therefore M.S. Wien's entry into the market at Rega's behest did not constitute a violation of the Rule. Carlton-Cambridge, however, was still under contract to complete the distribution (see pp. 9-10, supra), and the mere fact that it was not actively complying with the contract cannot be interpreted as a completion of the distribution. Subsection (c)(3) of the Rule, 17 CFR 10b-6(c)(3), deems the participation of a person subject to the rule ended, if he is an underwriter, only

> "when he has distributed his participation, including all other securities of the same class acquired in connection with the distribution."

See also R.A. Holman v. Securities and Exchange Commission, 366 F.2d 446, 449 (C.A. 2, 1966). Thus, until Rega informed Dennison that his agreed upon

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52/ In Zenith Corp., the Court stated: "In applying the clearly erroneous standard to the findings of a district court sitting without a jury, appellate courts must constantly have in mind that their function is not to decide factual issues de novo. The authority of an appellate court, when reviewing the findings of a judge as well as those of a jury, is circumscribed by the deference it must give to decisions of the trier of the fact, who is usually in a superior position to appraise and weigh the evidence. The question for the appellate court under Rule 52(a) is not whether it would have made the findings the trial court did, but whether 'on the entire evidence [it] is left with the definite and firm conviction that a mistake has been committed'" (citations omitted).

participation had been ended or the securities deregistered 53/, Rega remained an underwriter with respect to the remaining portion of the Dennison issue and his bidding and purchasing and his inducing Wien to do the same were in violation of Rule 10b-6. Moreover, as the district court pointed out, "between June 2 and June 20, 1972 Carlton sold approximately 380,000 shares of Dennison to its customers and in most instances these were solicited transactions. The sale of such a large block of shares may be said to constitute a 'distribution.' Bruns Nordeman & Co., 40 S.E.C. 652, 660 (1961)." (112a; see also 803a-806a.) Cf. also, Collins Securities Corp., Securities Exchange Act Release No. 11,766 (October 23, 1975), 8 SEC Docket 250, 256, 54/ to the effect that Rule 10b-6 "precludes a person from buying stock in the market when he is at the same time participating in an offering of securities which is of such a nature as to give rise to a temptation on the part of that person to purchase for manipulative purposes."

D. Under all the Circumstances Coven's Conduct did not Meet the Standard the Law Requires

As reflected in the foregoing analysis of Coven's role in facilitating the frauds perpetrated on Dennison and the public, each of the actions omitted and the affirmative conduct undertaken by him was either negligent or reckless.

Even if some of his activities may arguably be independently insufficient to give rise to an injunction, when the events of the Dennison offering are viewed as a whole the glaring nature of Coven's misconduct becomes apparent.

53/ In fact the underwriting agreement called for telegraphic notification to the issuer (703a).

54/ Remanded on other grounds, C.A. D.C., No. 75-2200 (August 12, 1977), as modified September 23, 1977.

For,

> "logically the sum is often greater that [sic] the aggregate of the parts, and the cumulation of instances, each explicable only by extreme credulity or professional inexpertness, may have a probative force immensely greater than any one of them alone."

United States v. White, 124 F.2d 181, 185 (C.A. 2, 1941) (Learned Hand, J.).

A claim of ignorance (see Br. 14, 15-16, 18, 26), much less the recklessness involved here, far from serving to exonerate one who was in a position to be well-informed, may serve to sustain even a criminal conviction premised on reckless irresponsibility. See United States v. Henderson, 446 F.2d 960, 966 (C.A. 8, 1971): "It is well-established that ignorance of inculpatory facts due to a reckless disregard is no more a defense than ignorance of inculpatory law." See also, United States v. Benjamin, supra, 328 F.2d at 863.

Whether a defendant who is a purported expert and is in a position of responsibility actually is aware, or could by reasonable diligence have made himself aware, of the misconduct being engaged in by others is a question of fact to be resolved at trial. See Securities and Exchange Commission v. North American Research and Development Corporation, 424 F.2d 63, 83 (C.A. 2, 1970); Securities and Exchange Commission v. Frank, 388 F. 2d 486, 489 (C.A. 2, 1968). Here, after trial the district court so determined. That determination should not be disturbed on appeal unless shown to be "clearly erroneous." Zenith Corp. v. Hazeltine, supra, 395 U.S. at 123.

II. THE DISTRICT COURT APPLIED THE CORRECT LEGAL STANDARD TO COVEN'S CONDUCT IN FINDING THAT HE HAD AIDED AND ABETTED THE UNDERWRITER'S VIOLATIONS.

The district court's decision in this case was entered before the Supreme Court's decision in Ernst & Ernst v. Hochfelder, 425 U.S. 185 (1976), and Coven argues (Br. 30-31) that the negligence standard applied by the district court here was overruled by the Supreme Court in Hochfelder.

Hochfelder held that a private party could not recover damages under Section 10(b) of the Securities Exchange Act and Rule 10b-5 against an accountant for alleged negligence in connection with its audit of a broker-dealer. The plaintiff there contended that a more careful audit might have uncovered facts sufficient to arouse suspicion and to have required further inquiry that in turn might have led to discovery of the broker-dealer's fraud against the plaintiff, but there was no question that the defendants did not, in fact, know of the fraud. The Supreme Court held that the language and legislative history of Section 10(b) demonstrated that the Section was not intended to be the basis for private causes of action for damages in the absence of "scienter." More recently, in the context of another private damage action, the Supreme Court described its holding in Hochfelder as being that "a cause of action under Rule 10b-5 does not lie for mere negligence . . . ." Santa Fe Industries, Inc. v. Green, 430 U.S. 462, 472 (1977) (emphasis supplied).

A. The Negligence Standard was Correctly Applied by the District Court.

The Hochfelder court specifically left open "the question whether scienter is a necessary element in an action for injunctive relief under

Section 10(b) and Rule 10b-5." 55/ Id. at 194, n. 12. This action was commenced by the Commission pursuant to Section 20(b) of the Securities Act, 15 U.S.C. 77t(b), and Section 21(d) of the Securities Exchange Act of 1934, 15 U.S.C. 78u(d). In relevant part, these sections provide that the Commission may bring an action in the appropriate United States District Court to enjoin acts or practices which constitute or which will constitute violations of the respective statutes, and that "upon a proper showing a permanent or temporary injunction or restraining order . . . shall be granted . . . ." 56/

As the Court of Appeals for the First Circuit aptly observed in declining to find Hochfelder applicable to a Commission enforcement action:

> "From the standpoint of an SEC injunction against violations which the court finds are likely to persist, a defendant's state of mind is irrelevant. If proposed conduct is objectively within the Congressional definition of injurious to the public, good faith, however much it may be a defense to a private suit for past actions, see Ernst & Ernst v. Hochfelder * * *, should make no difference. Cf. SEC v. Capital Gains Research Bureau, Inc., ante."

Securities and Exchange Commission v. World Radio Mission, 544 F. 2d 535, 540-541 (C.A. 1, 1976) (citations omitted). World Radio Mission, like the instant case, involved both violations of Sections 10(b) of the Securities Exchange Act and Rule 10b-5 thereunder and of Section 17(a) of the Securities Act.

55/ Nor did the Supreme Court in Santa Fe Industries have occasion to address the issue of the level of culpability required in injunction actions.

56/ The language quoted is from Section 20(b) of the Securities Act. Section 21(d) of the Securities Exchange Act is identical in relevant part.

Because "[a]n injunction is designed to protect the public against conduct, not to punish a state of mind," id. at 541, the general equity jurisdiction granted the district court in the federal securities acts 57/ permits relief from the prospect of future harm to the public regardless of the actor's past state of mind. Cf., Securities and Exchange Commission v. Capital Gains Research Bureau, 375 U.S. 180, 193-194 (1963). In that case, the Supreme Court held that "[i]t is not necessary in a suit for equitable or prophylactic relief to establish all the elements required in a suit for monetary damages," id. at 193, and further stated:

> "To impose upon the Securities and Exchange Commission the burden of showing deliberate dishonesty as a condition precedent to protecting investors through the prophylaxis of disclosure would effectively nullify the protective purposes of the statute." Id. at 200.

Significantly, Capital Gains was referred to by the Supreme Court in Hochfelder when it noted that different standards of conduct might apply in Commission actions for equitable relief then in private damage actions, 425 U.S at 194, n.12.

As World Radio Mission pointed out (544 F. 2d at 540-541), this Court "correctly anticipated the Hochfelder outcome and required proof of scienter in private damage actions under Rule 10b-5, see, e.g., Lanza v. Drexel & Co., 2 Cir., 1973, 479 F. 2d 1277, [but did not consider] intent relevant in SEC injunction actions, see, e.g., SEC v. Shapiro, 2 Cir., 1974, 494 F. 2d 1301, 1308." Both cited cases charged violations of Section 10(b) of the Securities Exchange Act and Rule 10b-5. The former was a private action for damages, and this Court held that some element of scienter was

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57/ Securities and Exchange Commission v. Management Dynamics, supra, 515 F. 2d at 808.

was required. 58/ The latter was an injunction action brought by the Commission, and this Court reaffirmed its prior holdings as to the applicability of the negligence standard.

The Hochfelder holding reflected the Supreme Court's concern that a negligence standard would both disrupt the statutory scheme of the "carefully drawn express civil remedies" in the Securities Act and the Securities Exchange Act 59/ and "would significantly broaden the class of plaintiffs who may seek to impose liablity upon accountants and other experts who perform services or express opinions with respect to matters under the Acts," 60/ with the consequent spectre of "liability in an indeterminate amount for an indeterminate time to an indeterminate class." 61/ Such concerns, while relevant to a private damage action such as Hochfelder, are inapplicable to the instant action for equitable relief, which, as we have noted, supra, p. 43, was instituted pursuant to the express provisions of both the Securities Act and the Securities Exchange Act. In Commission actions, where the Commission appears "not as an ordinary litigant but as a statutory guardian charged with safeguarding the public interest in enforcing the securities

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58/ See also the discussion in Judge Friendly's concurring opinion in Securities and Exchange Commission v. Texas Gulf Sulphur Co., 401 F. 2d 833, 866-867 (C.A. 2, 1968), certiorari denied, sub nom. Coates v. Securities and Exchange Commission, 394 U.S. 976 (1969).

59/ Ernst & Ernst v. Hochfelder, supra, 425 U.S. at 200-201.

60/ Id. at 214, n. 33.

61/ Id. at 215, n. 33, quoting from Ultramares Corp. v. Touche, 255 N.Y. 170, 179-180, 174 N.E. 441, 444 (1931).

laws," it must only establish what the statute requires. 62/ Thus, "'[p]roof of irreparable injury or the inadequacy of other remedies as in the usual suit for injunction' is not required." 63/

Subsequent to Hochfelder, it was urged in Securities and Exchange Commission v. Universal Major Industries, 546 F. 2d 1044 (C.A. 2, 1976), that the Commission must prove scienter in an injunction action, but this Court held the negligence standard was sufficient, id. at 1047. There, this Court "made it clear" that the law in this Circuit is that "in SEC proceedings seeking equitable relief, a cause of action may be predicated on negligence alone, and scienter is not required." Id. at 1047 (emphasis supplied). While Universal Major Industries involved an attorney who aided and abetted only violations of Section 5 of the Securities Act, this Court there held that Hochfelder did not require it to overrule its former cases: Securities and Exchange Commission v. Management Dynamics, Inc., 515 F. 2d 801 (C.A. 2, 1975); Securities and Exchange Commission v. Spectrum, Ltd., 489 F. 2d 535 (C.A. 2, 1973); and Securities and Exchange Commission v. North American Research & Development Corp., 424 F. 2d 63 (C.A. 2, 1970). Although each of these decisions cited in Universal Major Industries involved appellants who aided and abetted Section 5 violations, those appellants also had violated antifraud provisions, including Section 10(b) of the Securities Exchange Act and Rule 10b-5. This Court, noting that in these decisions it had held

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62/ 3 L. Loss, Securities Regulation 1979 (2d ed., 1961) (footnotes omitted). Unlike private plaintiffs, if the Commission is denied relief, it has no remedy at law which it might choose to pursue.

63/ Securities and Exchange Commission v. Management Dynamics, supra, 515 F. 2d at 808.

that in a Commission injunction proceeding a showing of negligence was sufficient, stated in Universal Major Industries that "Hochfelder, which was a private suit for damages, does not undermine our prior holdings." 546 F. 2d at 1047.

In Securities and Exchange Commission v. Spectrum, Ltd., supra, 489 F. 2d 535 (C.A. 2, 1973), this Court considered conduct comparable to that in the present case—an attorney's opinion letters used to facilitate the fraudulent sale of unregistered securities. Chief Judge Kaufman noted that, although the attorney may not have been involved in the actual misconduct, "he could be liable, nevertheless, as an aider and abettor to [the] illicit venture." Id. at 541. 64/ In rejecting the district court's test that required "actual knowledge of the improper scheme plus an intent to further that scheme," this Court characterized that test as

> "a sharp and unjustified departure from the negligence standard which we have repeatedly held to be sufficient in the context of enforcement proceedings seeking equitable or prophylactic relief."

Id. This Court there rejected a suggestion comparable to Coven's in this case (Br. 29, 33) that imposing a duty to investigate the activities of others with whom he is in a position to communicate would place an undue burden on the attorney, stating, 489 F. 2d at 541-542:

> "The legal profession plays a unique and privotal role in the effective implementation of the securities laws.

64/ Liability may be imposed on persons who aid and abet violations of the federal securitis laws. See, e.g., Securities and Exchange Commission v. Universal Major Industries, 546 F. 2d 1044, 1045-1047 (C.A. 2, 1976); Securities and Exchange Commission v. Management Dynamics, Inc., 515 F. 2d 801 (C.A. 2, 1975); Securities and Exchange Commission v. Timetrust, 28 F. Supp. 34 (N.D. Cal., 1939), reversed in part on other grounds, 130 F. 2d 214 (C.A. 9, 1942). The question was left open in Ernst & Ernst v. Hochfelder, supra, 425 U.S. at 184, n. 12.

> Questions of compliance with the intricate provisions of these statutes are ever present and the smooth functioning of the securities markets will be seriously disturbed if the public cannot rely on the expertise proffered by an attorney when he renders an opinion on such matters."

A lawyer may not plead ignorance and "escape liablity for fraud by closing his eyes to what he saw and could readily understand." Securities and Exchange Commission v. Frank, 388 F. 2d 486, 489 (C.A. 2, 1968). He is "not free to ignore the commercial substance of a transaction which could obviously be misleading to stockholders and the investing public," Securities and Exchange Commission v. National Student Marketing Corporation, 402 F. Supp. 641, 647 (D. D.C., 1975), or to ignore "what should [be] evident to him as a lawyer with some expertise in corporate mergers and acquisitions," id. at 649. Neither lawyers nor accountants "should be able to escape criminal liability on a plea of ignorance when they have shut their eyes to what was plainly to be seen or have represented a knowledge they knew they did not possess." United States v. Benjamin, 328 F. 2d 854, 863 (C.A. 2, 1964). 65/ As this Court stressed in Securities and Exchange Commission v. Spectrum, Ltd., supra, 489 F. 2d at 542:

> "The public trust demands more of its legal advisers then 'customary' activities which prove to be careless."

65/ In the light of the treatment of lawyers and accountants in the same category, it is relevant that with respect to an accountant it has been held in a criminal case that he may not "shut his eyes in reckless disregard of his knowledge that highly suspicious figures, known to him to be suspicious, were being included in the unaudited earnings figures." United States v. Natelli, 527 F. 2d 311, 320 (C.A. 2, 1975), certiorari denied, 425 U.S. 934 (1976).

Coven suggests (Br. 17) that it is improper to hold him accountable as an aider and abettor for inaction. We have seen, however, that he was active in facilitating the deposit of the "net funds" and in assuring both the issuer and the escrow agent that the "all or none" portion of the issue had been completed and that the escrowed funds might be disbursed, although the escrow account contained less than called for in documents he had prepared. This Court, in Spectrum, stated that it did not believe "that imposition of a negligence standard with respect to the conduct of a secondary participant is overly strict" with respect to the conduct of the attorney there involved, whose opinion letters had facilitated the fraud of others. In any event, it has been held that

> "one who aids and abets a fraudulent scheme may be held accountable, even though his assistance consists of mere silence or inaction."

Kerbs v. Fall River Industries, Inc., 502 F. 2d 731, 740 (C.A. 10, 1974); Strong v. France, 474 F. 2d 747, 752 (C.A. 9, 1973).

B. Even if Hochfelder were Arguably Applicable to Commission Enforcement Actions Under Section 10(b) of the Securities Exchange Act, the Outcome of This Action Should not be Affected

1. Coven's Reckless Conduct is Sufficient to Meet the Scienter Requirement Established by the Supreme Court in Hochfelder for Private Actions Under Section 10(b) and Rule 10b-5.

Hochfelder also left open "the question whether, in some circumstances, reckless behavior is sufficient for civil liability under 10(b) and Rule 10b-5," 425 U.S. at 194, n.12, even in a private action. The Court of Appeals for the Seventh Circuit recently held in a private damage action premised

on Section 10(b) of the Securities Exchange Act and Rule 10b-5, subsequent to Hochfelder, that "reckless nondisclosure" is a sufficient basis for liability. Sundstrand v. Sun Chemical Corp., 553 F.2d 1033, 1044 (C.A. 7, 1977). As we have seen, Santa Fe Industries, Inc. v. Green, supra, 430 U.S. at 472, suggests that something more than "mere negligence" is sufficient. In a private action under Section 10(b) and Rule 10b-5, this Court has described "willful or reckless disregard for the truth" as an instance where the actor

> "failed or refused, after being put on notice of a possible material failure of disclosure, to apprise [himself] of the facts where [he] could have done so without any extraordinary effort."

Lanza v. Drexel & Co., 479 F. 2d 1277, 1306 (C.A. 2, 1973). As we have shown, Coven's conduct with respect to the Dennison offering was reckless under that standard.

2. The District Court's Finding as to Coven's Violations of Section 17(a) of the Securities Act and Commission Rules 10b-6 and 10b-9 Under the Securities Exchange Act, Without Reference to Rule 10b-5, are Sufficient to Support the Relief Granted.

The scienter requirement articulated by the Supreme Court in Hochfelder, even if applicable to the present case, would have little bearing on the validity of the injunction issued against Coven, who was found by the district court to have aided and abetted violations not only of Section 10(b) and Rule 10b-5, but also of Section 17(a) of the Securities Act of 1933. Section 17(a), although in many respects identical to Rule

10b-5, is a statutory proscription rather than an administrative regulation. Its application is, therefore, not bound by the rationale of the holding of the Hochfelder decision.

The statutory language of Section 17(a) of the Securities Act, upon which Rule 10b-5 was modeled, is not limited by the statutory "words 'manipulative or deceptive' used in conjunction with 'device or contrivance' . . .," which to the Hochfelder court "strongly suggest[ed] that Section 10(b) was intended to proscribe [only] knowing or intentional misconduct. 425 U.S. at 197. Nor was Section 17(a) intended to be so limited. Regardless, therefore, of the hypothetical applicability of the Hochfelder decision to a Commission injunctive action brought under Rule 10b-5, the district court's issuance of an injunction against Coven may be upheld under Section 17(a). As the Court of Appeals for the First Circuit noted in Securities and Exchange Commission v. World Radio Mission, supra, 544 F. 2d at 541, n. 10 (C.A. 1, 1976):

> "Section 17(a), however, is a congressional enactment, not an SEC rule, and it contains the same language which the Hochfelder Court recognized did not require scienter."

See also, Securities and Exchange Commission v. Universal Major Industries, supra, 546 F. 2d at 1046-1047. 66/

Hochfelder, moreover, did not involve any of the specific anti-manipulative rules promulgated under Section 10(b) of the Securities Exchange Act, as distinguished from the general language of Rule 10b-5. It would be anomalous to apply the result reached by the Court in Hochfelder to

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66/ But see Securities and Exchange Commission v. American Realty Trust, 429 F. Supp. 1148 (E.D. Va., 1977), appeal pending, C.A. 4, No. 77-1839.

Commission Rules 10b-6 and 10b-9, violations of which are also involved in this action. Both of these rules identify specific conduct defined by the Commission to effectuate the Congressional prohibition against the use of any manipulative or deceptive device or contrivance under the Commission's statutory authority in Section 10(b) of the Securities Exchange Act to prescribe rules "necessary and appropriate in the public interest or for the protection of investors." Violation of such per se prohibitions as are contained in the two rules is sufficient to warrant imposition of even criminal liability:

> "If a man intentionally adopts certain conduct in certain circumstances known to him, and that conduct is forbidden by the law under those circumstances, he intentionally breaks the law in the only sense in which the law ever considers intent."

Ellis v. United States, 206 U.S. 246, 257 (1907)(Holmes, J.), cited in Arthur Lipper Corp. v. Securities and Exchange Commission, 547 F. 2d 171, 181, n. 7 (C.A. 2, 1976). 67/

Breach of the specific requirements of these rules which caused injury would not ordinarily be excused, because negligent, any more than failure to heed a traffic signal resulting in injury is excused in an action for damages because the conduct was only negligent. No less, in an action for prospective relief such as this one, which does not seek the imposition of criminal liability or even monetary damages, need a court permit negligent, much less reckless, conduct.

Whatever language the majority of the Court may have used in Hochfelder, that case must be viewed in the context of the charge that an

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67/ Lipper sustained the Commission's finding of violation of Section 10(b) and Rule 10b-5 in an administrative proceeding.

accountant had violated a general antifraud and anti-manipulation rule and that the negligence there involved was not embraced within the usual meaning of those terms. The Court was not deciding whether a careless violation of a specific prohibition, such as is involved in Rules 10b-6 and 10b-9, would state a cause of action. And in light of the fact that the Court even refused to decide that negligence would not sustain a cause of action under the broad language of Rule 10b-5, if brought by the Commission, we submit that a majority of the Court has not in any way indicted that more than negligence would be required for a violation of those rules promulgated pursuant to Section 10(b) that have specific prohibitions.

III. THE DISTRICT COURT DID NOT ABUSE ITS DISCRETION IN ENJOINING COVEN FROM FUTURE VIOLATIONS OF ANTIFRAUD AND ANTI-MANIPULATION PROVISIONS OF THE FEDERAL SECURITIES LAWS.

A. In View of the Violations Established and the Nature of Coven's Participation, Injunctive Relief Was Called For.

The district court twice considered the appropriateness of injunctive relief against Coven. It first determined an injunction was appropriate after the trial. On Coven's motion for reconsideration, it again "assessed the facts elicited at trial and . . . weighed all the proper considerations" (117a); it then affirmed its previous decision (id.).

This Court has stated in Securities and Exchange Commission v. Manor Nursing Centers, Inc., 458 F. 2d 1082, 1100 (C.A. 2, 1972):

> "In an action . . ., where the SEC sought injunctive relief . . . a district court has broad discretion to enjoin possible future violations of law where past violations have been shown and the court's determination that the public interest requires the imposition of a permanent restraint should not be disturbed on appeal unless there has been a clear abuse of discretion" (citations omitted).

The burden is on the party seeking to overturn the district court's exercise of discretion, and the burden "necessarily is a heavy one." Id. 68/

The traditional equitable prerequisites of injunctive relief, including a showing of irreparable injury and inadequacy of legal remedies, 69/ are inapplicable where an agency enforces remedial legislation, such as

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68/ Securities and Exchange Commission v. Culpepper, 270 F.2d 241, 250 (C.A. 2, 1959).

69/ See Rondeau v. Mosinee Paper Corp., 422 U.S. 49, 60-61 (1975).

the Securities Act of 1933 and the Securities Exchange Act of 1934 70/ and seeks to enjoin possible future violations of law for the protection of the public. 71/ In Management Dynamics, this Court stated, 515 F.2d at 808-809:

> "[T]he SEC appears in these proceedings not as an ordinary litigant, but as a statutory guardian charged with safeguarding the public interest in enforcing the securities laws. Hence, by making the showing required by statute that the defendant 'is engaged or about to engage' in illegal acts, the Commission is seeking to protect the public interest, and 'the standard of the public interest, not the requirements of private litigation, measure the propriety and need for injunctive relief.' Hecht Co. v. Bowles, 321 U.S. at 331 . . ."

Once a determination has been made that a violation, or violations, have been committed, the "critical question is whether there is a reasonable likelihood that the wrong will be repeated." Securities and Exchange Commission v. Management Dynamics, supra, 515 F. 2d at 807. 72/ A court may base its determination of the likelihood of future violations on past violations. 73/ In Securities and Exchange Commission v. First American Bank

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70/ See Affiliated Ute Citizens v. United States, 406 U.S. 128, 151 (1972); Superintendent of Insurance v. Bankers Life and Casualty Co., 404 U.S. 6, 12 (1971); Tcherepnin v. Knight, 389 U.S. 332, 336 (1967).

71/ Securities and Exchange Commission v. Capital Gains Research Bureau, Inc., 375 U.S. 180, 195 (1963).

72/ Securities and Exchange Commission v. Manor Nursing Centers, Inc., 458 F. 2d 1082, 1100 (C.A. 2, 1972); Securities and Exchange Commission v. Culpepper, 270 F. 2d 241, 249 (C.A. 2, 1959).

73/ Securities and Exchange Commission v. Management Dynamics, Inc., supra, 515 F.2d at 807; Securities and Exchange Commission v. Shapiro, 494 F.2d 1301, 1308 (C.A. 2, 1974); Securities and Exchange Commission v. First American Bank and Trust Co., 481 F.2d 673, 682 (C.A. 8, 1973); Securities and Exchange Commission v. Manor Nursing Centers, Inc., supra, 458 F.2d at 1100; Securities and Exchange Commission v. Keller Corp., 323 F.2d 397, 402 (C.A. 7, 1963).

and Trust Company, 481 F.2d 673, 682 (C.A. 8, 1973), the court considered that past wrongs may substantiate an expectation of future misconduct, and stated that the "inference is even stronger when the wrongdoers insist that their actions are legitimate and do not violate the [Securities] Act." 74/

In the instant action, the district court found a reasonable likelihood that Coven would continue to engage in similar violations in the future, (98a), and was not convinced that Coven had demonstrated otherwise (id.) See Securities and Exchange Commission v. Culpepper, 270 F.2d 241, 249 (C.A. 2, 1959). 75/ The district court concluded on the basis of the evidence that Coven "displayed very little if any sensitivity to his responsibilities" (116a) and that, even upon becoming aware of Rega's questionable activities, Coven's "actions reflected little dismay at what had transpired." Id. The fact (supra p. 18) that Coven "embarked on a new issue again with Carlton as the underwriter" (117a) strongly supports the inference that a similarly lackadaisical approach to his responsibilities may be expected in the future. See, Securities and Exchange Commission v. First American Bank and Trust Company, supra, 481 F.2d at 682.

Coven insists (Br. 15-16, 29) that his inaction and acquiescence in the face of increasing danger signals were proper and that, in any event, there was nothing he could or should have done to prevent the underwriter's

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74/ Accord, Securities and Exchange Commission v. Manor Nursing Centers, Inc., supra, 458 F. 2d at 1101; Securities and Exchange Commission v. MacElvain, 417 F. 2d 1134, 1137 (C.A. 5, 1969), certiorari denied, 397 U.S. 972 (1970).

75/ In Culpepper this Court suggested that once the Commission had shown a past violation the burden shifted to the defendant to demonstrate that there was no likelihood of future violations, 270 F. 2d at 249.

multiple frauds on both his own client, Dennison, and on the investing public. But, as discussed supra, p. 33, the suggestion that Coven's inaction on the multiple occasions described was only negligent or inadvertent is dispelled by Coven's May 30 opinion letter authorizing the closing and his subsequent letter, confirming to the bank the sale of exactly 3,075,000 shares. Under these circumstances the district court

> "may infer from a wanton or even careless willingness to take a chance on the legality of questionable transactions that a defendant is about to similarly violate the Act if afforded an opportunity to do so in the absence of an injunction . . . ."

Securities and Exchange Commission v. Mono-Kearsarge Consolidating Mining Co., 167 F. Supp. 248, 261 (D. Utah, 1958).

Coven argues that the issuance of an injunction in this case should be reversed because of a lack of intent on his part to violate the law and in view of his absence of bad faith (Br. 33). 76/ And he points out (id.) that the district court acknowledged that he had asserted he had changed his business practices (117a), but he claims that the court did not give this proper weight. Even if the court believed his assertion, it is settled

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76/ Although Coven makes no corresponding argument in his brief, he states as an issue presented (Br. 2) the appropriateness of the issuance of an injunction which applies broadly to illegal activity with respect to "any other security." The fact that Coven apparently remains in the field of securities law suggests the importance of that injunction (see Coven Br. 27, 32). Such an injunction is well within a district court's discretion. Securities and Exchange Commission v. Manor Nursing Centers, supra, 458 F.2d at 1102; Securities and Exchange Commission v. North American Research and Development Corp., 424 F. 2d 632 (C.A. 2, 1970), affirming, 375 F. Supp. 465, 475. see also, Federal Trade Commission v. Henry Broch & Company, 368 U.S. 360 (1962) (cease and desist order applicable to "any other buyer"); National Labor Relations Board v. Ochoa Fertilizer Corp., 368 U.S. 318 (1961) (cease and desist order applicable to "any other employer" and "any other labor organization").

law that mere cessation of illegal activities does not negate the propriety of an injunction, particularly as the reform was prompted by the institution of legal action against the wrongdoer. 77/ Moreover as suggested by the district court's opinion, see supra, pp. 23-24, the question of Coven's good faith and lack of intent to violate the securities laws is open to some doubt.

The dishonest or careless practitioner is able, more so than others, to inflict serious injury on the investing public.

> "The legal profession plays a unique and pivotal role in the effective implementaion of the securities laws. Questions of compliance with the intricate provisions of these statutes are ever present and the smooth functioning of the securities markets will be seriously disturbed if the public cannot rely on the expertise proffered by an attorney when he renders an opinion on such matters."

Securities and Exchange Commission v. Spectrum, Ltd., supra, 489 F. 2d at 541-542. 78/ Coven's disregard of the requirements of the federal securities laws goes far beyond "mere mistakes in legal judgment," Securities and Exchange Commission v. Century Investment Transfer Corp., [1971-72] CCH Fed. Sec. L. Rep. ¶93,232 (S.D.N.Y., 1971), to the point where he made continuing contributions to the success of the schemes planned and perpetrated by Rega and Carlton-Cambridge.

77/ United States v. Parke-Davis & Co., 362 U.S. 29, 47-48 (1960); Securities and Exchange Commission v. Management Dynamics, supra, 515 F. 2d at 807; Securities and Exchange Commission v. Manor Nursing Centers, Inc., supra, 458 F. 2d at 1101; Securities and Exchange Commission v. Boren, 283 F. 2d 312, 313-314 (C.A. 2, 1960); Securities and Exchange Commission v. Keller Corp., 323 F. 2d 397, 402 (C.A. 7, 1963).

78/ See also Securities and Exchange Commission v. National Student Marketing Corporation, supra, 402 F. Supp. at 649.

As this Court stated in United States v. Benjamin, 328 F. 2d 854 863 (C.A. 2, 1969), with respect to the criminal liability of attorneys and other professionals in the securities field:

> "In our complex society the accountant's certificate and the lawyer's opinion can be instruments for inflicting pecuniary loss more potent than the chisel or the crowbar. . . . Congress . . . could not have intended that men holding themselves out as members of these ancient professions should be able to escape criminal liability on a plea of ignorance when they have shut their eyes to what was plainly to be seen or have represented a knowledge they knew they did not possess."

Accord, Securities and Exchange Commission v. Frank, 388 F. 2d 486, 489 (C.A. 2, 1968).

B. Other Considerations

Coven urges the Court to consider the impact of an injunction upon his professional standing as an attorney (Br. 34). If Coven is suggesting that he may be subject to disbarment or disciplinary proceedings, such concerns are appropriately considered in other forums. 79/ Cf., Securities and Exchange Commission v. Culpepper, supra, 270 F. 2d at 252; Securities and Exchange Commission v. Scott Taylor & Co., supra, 183 F. Supp. at 909.

79/ One of the other forums is the Commission itself. Pursuant to Rule 2(e) of its Rules of Practice, 17 CFR 201.2(e), the Commission, "with due regard to the public interest," "may deny, temporarily or permanently, the privilege of appearing or practicing before it . . ." to any professional or expert, including an attorney, who has been permanently enjoined by any court of competent jurisdiction in an action brought by the Commission for violation or aiding and abetting the violation of any provision of the federal securities securities laws or rules thereunder, or to have been found to have committed such a violation.

CONCLUSION

For the foregoing reasons, the entry of the order of permanent injunction should be affirmed in all respects.

Respectfully submitted,

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April 1977

STATUTORY APPENDIX

SECURITIES ACT OF 1933, 15 U.S.C. 77a, et seq.

15 U.S.C. 77q(a)

SEC. 17. (a) It shall be unlawful for any person in the offer or sale of any securities by the use of any means or instruments of transportation or communication in interstate commerce or by the use of the mails, directly or indirectly—

(1) to employ any device, scheme, or artifice to defraud, or

(2) to obtain money or property by means of any untrue statement of a material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(3) to engage in any transaction, practice, or course of business which operates or would operate as a fraud or deceit upon the purchaser.

SECURITIES EXCHANGE ACT OF 1934, 15 U.S.C. 78a, et seq.

15 U.S.C. 78j(b)

SECTION 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—

(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

RULES UNDER THE SECURITIES EXCHANGE ACT OF 1934

17 CFR 240.0-1, et seq.

Rule 10b-5

§ 240.10b–5 Employment of manipulative and deceptive devices.

It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interestate commerce, or of the mails or of any facility of any national securities exchange,

(a) To employ any device, scheme, or artifice to defraud,

(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

Rule 10b-6

§ 240.10b–6 Prohibitions against trading by persons interested in a distribution.

(a) It shall constitute a "manipulative or deceptive device or contrivance" as used in section 10(b) of the act for any person,

(1) Who is an underwriter or prospective underwriter in a particular distribution of securities, or

(2) Who is the issuer or other person on whose behalf such a distribution is being made, or

(3) Who is a broker, dealer, or other person who has agreed to participate or is participating in such a distribution, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange, either alone or with one or more other persons, to bid for or purchase for any account in which he has a beneficial interest, any security which is the subject of such distribution, or any security of the same class and series, or any right to purchase any such security, or to attempt to induce any person to purchase any such security or right, until after he has completed his participation in such distribution: *Provided, however,* That this section shall not prohibit (i) transactions in connection with the distribution effected otherwise than on a securities exchange with the issuer or other person or persons on whose behalf such distribution is being made or among underwriters, prospective underwriters or other persons who have agreed to participate or are participating in such distribution; (ii) unsolicited privately negotiated purchases, each involving a substantial amount of such security, effected neither on a securities exchange nor from or through a broker or dealer; or (iii) purchases by an issuer effected more than forty days after the commencement of the distribution for the purpose of satisfying a sinking fund or similar obligation to which it is subject; or (iv) odd-lot transactions (and the off-setting round-lot transactions hereinafter referred to) by a person registered as an odd-lot dealer in such security on a national securities exchange who offsets such odd-lot transactions in such security by round-lot transactions as promptly as possible; or (v) brokerage transactions not involving solicitation of the customer's order; or (vi) offers to sell or the solicitation of offers to buy the securities being distributed (including securities or rights acquired in stabilising) or securities or rights offered as principal by the person making such offer to sell or solicitation; or (vii) the exercise of any right or conversion privilege to acquire any security; or (viii) stabilising transactions not in violation of § 240.10b–7; or (ix) bids for or purchases of rights not in violation of § 240.10b–8; or (x) transactions effected on a national securities exchange in accordance with the provisions of a plan

(continued)

filed by such exchange under § 240.10b-2 (d) and declared effective by the Commission; or (xi) purchases or bids by an underwriter, prospective underwriter or dealer otherwise than on a securities exchange, 10 or more business days prior to the proposed commencement of such distribution (or 5 or more business days in the case of unsolicited purchases), if none of such purchases or bids are for the purpose of creating actual, or apparent, active trading in or raising the price of such security. In the case of securities offered pursuant to an effective registration statement under the Securities Act of 1933 the distribution shall not be deemed to commence for purposes of this subdivision prior to the effective date of the registration statement.

(b) The distribution of a security (1) which is immediately exchangeable for or convertible into another security, or (2) which entitles the holder thereof immediately to acquire another security, shall be deemed to include a distribution of such other security within the meaning of this section.

(c) The following shall be applicable for the purposes of this section.

(1) The term "underwriter" means a person who has agreed with an issuer or other person on whose behalf a distribution is to be made (i) to purchase securities for distribution or (ii) to distribute securities for or on behalf of such issuer or other person or (iii) to manage or supervise a distribution of securities for or on behalf of such issuer or other person.

(2) The term "prospective underwriter" means a person (i) who has agreed to submit or has submitted a bid to become an underwriter of securities as to which the issuer, or other person on whose behalf the distribution is to be made, has issued a public invitation for bids, or (ii) who has reached an understanding, with the issuer or other person on whose behalf a distribution is to be made, that he will become an underwriter, whether or not the terms and conditions of the underwriting have been agreed upon.

(3) A person shall be deemed to have completed his participation in a particular distribution as follows: (i) The issuer or other person on whose behalf such distribution is being made, when such distribution is completed; (ii) an underwriter, when he has distributed his participation, including all other securities of the same class acquired in connection with the distribution, and any stabilization arrangements and trading restrictions with respect to such distribution to which he is a party have been terminated; (iii) any other person, when he has distributed his participation. A person, including an underwriter or dealer, shall be deemed for purposes of this subparagraph to have distributed securities acquired by him for investment.

(d) The provisions of this section shall not apply to any of the following securities: (1) "Exempted securities" as defined in section 3 (a) (12) of the act, including securities issued, or guaranteed both as to principal and interest, by the International Bank for Reconstruction and Development; or (2) face-amount certificates issued by a face-amount certificate company, or redeemable securities issued by an open-end management company or a unit investment trust. Any terms used in subparagraph (2) of this paragraph which are defined in the Investment Company Act of 1940 shall have the meanings specified in such act.

(e) The provisions of this rule shall not apply to any distribution of securities by an issuer to its employees, or to employees of its subsidiaries, or to a trustee or other person acquiring such securities for the account of such employees, pursuant to (1) a stock option plan involving only "qualified stock options," or qualifying as an "employee stock purchase plan" as those terms are defined in sections 422 and 423 of the Internal Revenue Code of 1954, as amended or "restricted stock options" as defined in section 424(b) of the Internal Revenue Code of 1954, as amended, provided however, that for the purposes of this paragraph an option which meets all of the conditions of that section other than the date of issuance shall be deemed to be "restricted stock options"; or (2) a savings, investment, or stock purchase plan providing for both (i) periodic payments (or payroll deductions) for acquisition of securities by participating employees and (ii) periodic purchases of the securities by participating employees, or the person acquiring them for the account of such employees.

(f) This section shall not prohibit any transaction or transactions if the Commission, upon written request or upon its own motion, exempts such transaction or transactions, either unconditionally or on specified terms and conditions, as not constituting a manipulative or deceptive device or contrivance comprehended within the purpose of this section.

§ 240.10b-9 Prohibited representations in connection with certain offerings.

(a) It shall constitute a "manipulative or deception device or contrivance", as used in section 10(b) of the Act, for any person, directly or indirectly, in connection with the offer or sale of any security, to make any representation:

(1) To the effect that the security is being offered or sold on an "all-or-none" basis, unless the security is part of an offering or distribution being made on the condition that all or a specified amount of the consideration paid for such security will be promptly refunded to the purchaser unless (i) all of the securities being offered are sold at a specified price within a specified time, and (ii) the total amount due to the seller is received by him by a specified date; or

(2) To the effect that the security is being offered or sold on any other basis whereby all or part of the consideration paid for any such security will be refunded to the purchaser if all or some of the securities are not sold, unless the security is part of an offering or distribution being made on the condition that all or a specified part of the consideration paid for such security will be promptly refunded to the purchaser unless (i) a specified number of units of the security are sold at a specified price within a specified time, and (ii) the total amount due to the seller is received by him by a specified date.

(b) This rule shall not apply to any offer or sale of securities as to which the seller has a firm commitment from underwriters or others (subject only to customary conditions precedent, including "market outs") for the purchase of all the securities being offered.

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

OFFICE OF THE
GENERAL COUNSEL

December 5, 1977

CERTIFIED MAIL

A. Daniel Fusaro, Esquire
Clerk, United States Court of Appeals
for the Second Circuit
United States Courthouse
Foley Square
New York, New York 10007

Re: Securities and Exchange Commission v. Coven,
No. 75-6080

Dear Mr. Fusaro:

Enclosed for filing in the above-captioned action are ten copies of the brief of the Securities and Exchange Commission, appellee.

I hereby certify that I have this day caused two copies of the enclosed brief to be served on the appellant by mail, as follows:

Bernard Jay Coven, Esquire
777 Third Avenue
New York, New York 10017

Sincerely yours,

Glynn L. Mays
Attorney

Enclosures